Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

October Term, 1994

GUILIO J. CONTI AND EDITH CONTI,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

Petition For Writ Of Certiorari
To The Sixth Circuit Court Of Appeals

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Was the Sixth Circuit's decision in conflict with the decision of the Eleventh Circuit in *United States v. Piccinonna*, 885 F.2d 1129 (11th Cir. 1989) (*en banc*), in ruling that polygraphs were per se excludible and contrary to this Court's decision in *Daubert v. Merrell Dow Pharmaceuticals*, 113 S.Ct. 2786, 125 L.Ed.2d 465 (1993)?

Petitioners say "Yes."

The Tax Court and Sixth Circuit Court of Appeals say "No."

Is it consistent with due process to permit the Internal Revenue Service to base deficiencies on calculations of a Taxpayer's "net worth" determined without a starting point of "reasonable certainty" and, in fact, based on a guess by the Internal Revenue Agent?

Petitioners say "No."

The Tax Court and Sixth Circuit Court of Appeals say "Yes."

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Guilio J. Conti and Edith Conti petition for a Writ of Certiorari to review the decision of the Sixth Circuit Court of Appeals, affirming the United States Tax Court, which held that there was a deficiency in Petitioners' Income Tax for the taxable years ending December 31, 1986 and December 31, 1987 and additions to tax for the same taxable years.

OPINIONS BELOW

Two opinions of the Tax Court and the Sixth Circuit Court of Appeals are attached in the Appendix. The opinion of the Tax Court with regard to polygraph evidence is reported at 99 T.C. No. 20, and the decision as to the merits is reported as T.C. Memo 1992-616. The opinion of the Sixth Circuit is recommended for publication but has not yet been published to the knowledge of the Petitioners.

JURISDICTION

Respondent-Appellee, Commissioner of Internal Revenue, issued a Notice of Deficiency to Petitioners-Appellants on April 11, 1990 asserting deficiencies in income tax and additions to tax for the calendar years 1986 and 1987. Pursuant to 26 USC §6213(a), Petitioners were timely filed in the United States Tax Court on July 6, 1990 giving the Tax Court jurisdiction pursuant to 26 USC

§7442. The Tax Court entered two Opinions, one on September 29, 1992 with regard to the admissibility of polygraph tests, and its Opinion with regard to the merits on October 19, 1992. Motions for Reconsideration were filed by the Petitioner with regard to the two Opinions on October 19, 1992 and November 18, 1992, respectively. These Motions were denied on December 1, 1992 and December 2, 1992, with the decision of the Tax Court entered on January 13, 1993. On January 29, 1993, a Notice of Appeal to the Sixth Circuit was timely filed pursuant to 26 USC §7483. This matter was appealable to the Sixth Circuit pursuant to 26 USC § 7482(b)(1)(A), as the Appellants are individuals legally residing in the State of Michigan. The Sixth Circuit entered its Opinion on November 9, 1994. Petitioner invokes the jurisdiction conferred on this Court by 28 USC §1254(I).

STATUTORY PROVISIONS INVOLVED

Federal Rule of Evidence 702:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

STATEMENT

Petitioners are 74 year old retired rigger who worked full time for forty-eight years with Ford Motor Company and his 74 year old wife, who had not worked outside the home since 1949. Guilio Conti retired from Ford on December 31, 1985. Shortly after Guilio Conti's retirement during 1986 and 1987, the Petitioners invested approximately $1.4 million in real estate. It has been the position of the government that the invested money came from some business enterprise operated by Petitioners in 1986 and 1987 that left absolutely no trace of its existence. The Internal Revenue Service audit began in April, 1988, and found no evidence of any business enterprise which was not fully reported. It has been the assertion of Petitioners that the bulk of the money came from an $800,000 cash hoard accumulated through the years by Petitioners, their mother and brother and the balance being advanced by their son, Mark Conti, from his own sources.

The Internal Revenue Service determined deficiencies in the Petitioners' income taxes for the years 1986 and 1987 and asserted fraud penalties. Such deficiencies were determined using the "net worth" method. There was absolutely no evidence concerning how much cash Petitioners kept on hand presented by the government other than the testimony of an inexperienced Revenue Agent on her first audit, which was thoroughly discredited on cross-examination. Accordingly, no starting point was established with reasonable certainty.

The Petitioners attempted to support their claim that they had $800,000 in cash prior to 1986 by submitting to a

polygraph exam conducted by the President of the Michigan Polygraph Association. The results of the polygraph exam indicated that both Petitioners were truthful in their assertions that they had an $800,000 cash hoard and had reported all their income in the years in question. Petitioners offered to submit to a polygraph examination by the Internal Revenue Service in accordance with the holding of *U.S. v. Piccinonna,* but the Government declined to conduct an examination. Expert testimony established that the polygraph is approximately 95% accurate when the subject passes. The statistical probability of both Petitioners being able to successfully *"beat"* the polygraph is about 1%.

Petitioners argued that the results of the polygraph exams should be admissible under FRE 702. The Tax Court held, basing its opinion on *Frye v. United States,* 54 App. D.C. 46, 293 F. 1013 (1923), the polygraph was not admissible. On October 19, 1992, the Tax Court sustained all deficiencies and penalties against Petitioner. By opinion dated November 9, 1994, the Sixth Circuit affirmed the decisions of the Tax Court, holding that the polygraph test had been taken "unilaterally" and accordingly, was inadmissible. The Sixth Circuit did not follow the Supreme Court's decision in *Daubert* and placed itself in clear conflict with the decision of the Eleventh Circuit in *United States v. Piccinonna,* 885 F.2d 1129 (11th Cir. 1989) *(en banc)* A Petition for Rehearing with Suggestion that the Rehearing be en banc was filed on November 22, 1994 and denied by the Sixth Circuit.

REASONS FOR GRANTING THE PETITION

The decisions of the Tax Court and Sixth Circuit in this case are contrary to the decision of this Court in *Daubert v. United States* and are in conflict with the decision of the Eleventh Circuit Court of Appeals in *United States v. Piccinonna*, 885 F.2d 1129 (11th Cir. 1989) *(en banc)*. Accordingly, it is suitable for review by this Court pursuant to Supreme Court Rule of Procedure 10.1(a). Further, the Courts below have sanctioned a new level of estimation in "net worth" cases. The Courts (including this Court, see *Holland v. United States*, 348 U.S. 121, 99 L Ed 150, 75 S.Ct. 127 (1954)) have always rightly emphasized that while the "net worth" method of determining unreported income is a necessary and proper tool of the Internal Revenue Service, it must be used with caution. Otherwise, the government can build inference upon inference, and, in essence, when they think that there has been under reporting of income, make the numbers up. That is what has occurred here. The decision of the Sixth Circuit gives the Internal Revenue Service a license to determine deficiencies against Taxpayers without sufficient evidence in just about any amount and in any year the Internal Revenue Service in its own untrammeled discretion, feels appropriate. This is not only a violation of due process but a negation of the rule of law. As such, it is certainly a matter of great importance to the nation's jurisprudence suitable for review by this Court.

I.

The Polygraph Issue

The Sixth Circuit held that the decision of the Tax Court excluding the polygraph results under *Frye* was not contrary to *Daubert* because, although the Court did not apply the formula required by *Daubert* and the Federal Rules of Evidence, it relied on "independent grounds" to exclude evidence. In effect, the Sixth Circuit has created an exception to *Daubert*. Prior to *Daubert*, the *Frye* case (*Frye v. United States*, 54 App. D.C. 46, 293 F. 1013 (1923)) was such an independent ground. *Daubert* specifically said that such independent grounds and separate tests and exceptions to the Federal Rules of Evidence were no longer permitted. "The Rules occupy the field, *United States v. Abel*, 469 U.S. 45, 49, 83 L.Ed.2d 450, 105 S.Ct. 465 (1984)" *Daubert* syllabus. A common law doctrine which finds support in the Rules can be explained by common law authority, but if the Court is "unable to find a particular common-law doctrine in the Rules", as in *Bourjaily v. United States*, 483 U.S. 171 (1987), the doctrine is superseded. Federal Rule of Evidence 702 governs the admissibility of scientific evidence. The *Daubert* tests should be applied to the evidence.

The decision of the Sixth Circuit to ignore *Daubert* and hold that a polygraph exam is not admissible because it is conducted "unilaterally" is particularly irrational. It is not necessary to notify opposing counsel prior to getting medical exam or conducting any other type of scientific inquiry. The other side must just have an opportunity to do its own medical exam or inquiry. The only reason to

prohibit "unilateral" polygraph tests but not other scientific evidence is an unfounded prejudice against polygraph examinations despite the fact that they are used and relied upon by private industry and law enforcement agencies throughout the country, including the Department of Justice and the FBI.

The Sixth Circuit, in its opinion, took the view that *Barnier v. Szentmiklosi,* 810 F.2d 594 (6th Cir. 1987) prohibited admissions of unilateral polygraphs. In fact, that case does not so hold. The decision in *Barnier* held that the stress of undergoing a polygraph exam "unilaterally" could not be used to buttress a Plaintiff's claim for damages in a civil suit for false arrest, because it was voluntarily incurred to terminate a criminal prosecution. However, as modified by Conti, it is clearly the present law in the Sixth Circuit that "unilateral" polygraph tests are per se inadmissible despite the decision of the Supreme Court in *Daubert* and the 11th Circuit in *Piccinonna.* However, in holding that unilateral polygraph tests do not cause stress as a factual matter, the Sixth Circuit has concluded that it will refuse to hear expert testimony to the contrary because its mind is totally closed. The assertion that unilateral polygraph tests do not cause stress is demonstrably wrong, and not even the government's expert asserted it. Petitioners' polygraph examiner testified that a high proportion of his clients flunk which would not occur if there was no stress. Furthermore, under laboratory conditions where the polygraph exam has been extensively tested and stress would be at a minimum, the validity of the tests is confirmed at a level of as high as 99%. But the Sixth Circuit has held that no polygraph expert can be heard to

testify that unilateral polygraph exams cause stress, are relevant and probative regardless of how much scientific proof there is of the proposition, and we are left like Galileo helplessly muttering that the earth does go around the sun.

There is no reason, under the Sixth Circuit's reasoning why *Frye* could not co-exist with *Daubert* as an independent ground outside of and subversive of the Federal Rules of Evidence, although that it is plainly contrary to the *Daubert* opinion. *Daubert* held that the Federal Rules of Evidence are determinative of all evidentiary questions in Federal Court. If independent grounds are to be permitted alongside the Rules of Evidence and *Daubert*, there is nothing to prevent any Court from adding whatever independent tests alongside of *Daubert* that it chooses. The uniformity of the Federal law of evidence is seriously compromised.

The decision is contrary to *United States v. Piccinonna*, 885 F.2d 1129 (11th Cir. 1989) *(en banc)*. The Sixth Circuit asserted that the Trial Court, under the *Piccinonna* rule may still exclude polygraph testimony in its sole discretion. However, this is a sound discretion, based upon factors and tests specifically set forth in *Piccinonna*, with regard to the qualifications of the examiner, the questions asked, or prejudicial test conditions. It is not within the Judge's sound discretion to exclude the test because he still adheres to *Frye* or because it was "unilaterally" administered. The *Piccinonna* Court acknowledges that most experts conduct their investigations "unilaterally" and all expert testimony could be excluded if all one side has to do to keep out the other side's experts is to refuse to stipulate. Under *Piccinonna*, the results of a polygraph

examination are admissible at trial to impeach or corroborate a witness' testimony if the opposing party has been given adequate notice that the polygraph results will be offered and has an opportunity to have its own expert conduct a polygraph examination of the witness on the same subject. Petitioners have fulfilled the conditions set forth in *Piccinonna* and the results of their polygraph examinations would be admissible in the Eleventh Circuit to corroborate their testimony.

Accordingly, not only is the decision of the Court contrary to *Daubert* but it is contrary to *Piccinonna*, creating a conflict between the circuits.

Any fear of polygraph examinations in the Courts is based on ignorance and misunderstanding. A polygraph machine is not a "lie detector." It is not intallible. It is, however, a reliable and useful tool in determining what the truth is, as even the Government's expert witness had to admit. The Sixth Circuit has decided that we should not use the means at our disposal to determine what the truth is and instead lets a travesty stand in triumph of pretense over justice.

II.

"Reasonable Certainty"

The Court acknowledges that the opening net worth in a net worth case must be proven with "reasonable certainty." It is further stated that the figure was "established with reasonable certainty based on Mrs. Conti's statements to Agent Keysor." In her testimony Keysor acknowledges Mrs. Conti never stated that her cash on had was $150,000 and further acknowledged that the

figure was a "guess" made by her. Nonetheless, the Court has approved of the Internal Revenue Service determination or guess that the Contis only had $150,000 of cash on hand. In *Holland v. United States*, 348 U.S. 121, 99 L Ed 150, 75 S. Ct. 127 (1954), this Court approved the use of the "net worth" method but was clear that the method needed to be used with caution.

> "While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint." *Holland v. United States*, 348 U.S. 129.
>
> "We agree with petitioners that an essential condition in cases of this type is the establishment with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset." *Holland v. United States*, 348 U.S. 132.

The government did not establish opening net worth with "reasonable certainty." It guessed. That was not just proved by a preponderance of the evidence, but proved beyond a reasonable doubt. To conclude that the original discredited testimony has established a fact to a "reasonable certainty" is to lapse into Orwellian doublespeak and to render the Taxpayer's right to a hearing meaningless.

CONCLUSION

The Petition for the Writ of Certiorari should be granted.

Respectfully submitted,

ROBERT B. PIERCE
PAUL T. MENGEL

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No: 93-1281

GUILIO J. CONTI and EDITH CONTI,

Petitioners - Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent - Appellee.

Before: **Martin, Ryan,** and **Suhrheinrich,** Circuit Judges.

JUDGMENT

(Filed Nov. 9, 1994)

ON APPEAL from a decision of the United States Tax Court.

THIS CAUSE was heard on the transcript of record from the Tax Court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ORDERED that the decision of the Tax Court is AFFIRMED on the merits. IT IS FURTHER ORDERED that the case is REMANDED for correction of the mathematical error, and recalculation of the petitioners' 1986 deficiency.

ENTERED BY ORDER OF THE COURT

/S/ Leonard Green
Leonard Green, Clerk

A True Copy.

Attest:

/s/ _____
Deputy Clerk

Issued as Mandate: 1-11-95

COSTS: 1,042.84 (To Be Recovered By Appellee)

Filing Fee.....$
Printing .....1,042.84$

Total .....1,042.84$

T.C. Memo. 1992-616

UNITED STATES TAX COURT

GUILIO J. AND EDITH CONTI, Petitioners *v.* COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 15131-90. Filed October 19, 1992.

R determined deficiencies in income tax and additions to tax for 1986 and 1987 using the net worth plus expenditures method. Ps claim that the increase in net worth determined by respondent was due to withdrawals from an $800,000 cash hoard and $550,000 in loans from their son.

Held: R's determination of deficiencies as amended is sustained.

Held further: Additions to tax under secs. 6653(b) and 6661 a amended are sustained.

Mark C. Pierce, Robert B. Pierce, and *Paul T. Mengel,* for petitioners.

Dennis C. Driscoll, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COLVIN, *Judge*: Respondent determined deficiencies in income tax of $116,410.57 for 1986 and $390,227.28 for 1987, and additions to tax for fraud under section 6653(b) and substantial understatement of income tax under section 6661.

In the answer respondent alternatively asserted the addition to tax for negligence under section 6653(a). By

amended answer, respondent asserted that petitioners' deficiency was $217,237 for 1986 and $339,021 for 1987. On brief respondent concedes that petitioners' deficiencies do not exceed $206,702 for 1986 and $322,343 for 1987.

After concessions, the issues for decision are:

1. Whether respondent's determination, including that petitioners had a $150,000 cash hoard on December 31, 1985, was arbitrary. We hold that it was not.

2. Whether petitioners had an $800,000 cash hoard on December 31, 1985, or received $550,000 in loans from their son during 1986 and 1987. We hold that they did not.

3. Whether petitioners are entitled to a $5,047 deduction for sales tax for 1986, and a $410 deduction for tax return preparation fees for 1987. We hold that they are not.

4. Whether petitioners have additional income of $893 for 1986 from the sale of their residence. We hold that they do.

5. Whether petitioners are liable for additions to tax for fraud under section 6653(b). We hold that they are.

6. Whether petitioners are liable for additions to tax for substantial understatement of tax under section 6661. We hold that they are.

7. Whether petitioners are liable for additions to tax for negligence under section 6653(a). We need not reach this issue in light of our holding on fraud.

Petitioners offered into evidence the results of polygraph tests to corroborate their cash hoard claim. We previously ruled that the results of these tests are not admissible. *Conti v. Commissioner,* 99 T.C. ___ (1992).

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. References to petitioners are to Mr. and Mrs. Conti.

1. Petitioners and Their Family

Petitioners are husband and wife who resided in Birmingham, Michigan, when the petition was filed. They were married in 1949 and had three sons, Chris, Gary, and Mark (the oldest). Petitioners' sons were in their late twenties to late thirties and petitioners were in their late sixties during the years at issue.

a. Mr. Conti

Mr. Conti was born in 1921. He has a fifth grade education, and began work at age 14. Mr. Conti worked for Ford Motor Co. (Ford) beginning in 1937, and retired in 1985. From 1971 through 1985 he received $679,206 in wages from Ford. He was in reasonably good health during the years at issue.

Mr. Conti served in the United States Army from 1942 through 1945. He fought in World War II in North Africa and Europe. He was paid $60 per month by the Army.

Mr. Conti inherited $10,000 from his father in 1970, and $12,637 from his brother in 1984. Mr. Conti never made bank deposits. He gave all of the cash he acquired to Mrs. Conti.

Mr. Conti purchased a deferred annuity for $150,000 on November 27, 1981. He withdrew $152,020.51 from the annuity account in July 1984, and received a final distribution of $38,610.33 on February 9, 1988.

b. Mrs. Conti

Mrs. Conti is a high school graduate with varied work experience before her marriage. She handled the family finances.

In 1986 and 1987 she made more than 300 deposits in at least three banks totaling over $950,000. At least 130 of the deposits were cash, totaling over $375,000. Also in those years petitioners bought and sold at least 12 real properties. These activities are discussed below.

Mrs. Conti is a little hard of hearing and has high blood pressure.

c. Mark Conti

Mark Conti, petitioners' son, is a college graduate. In the 1980s, he syndicated video games, financed and

developed racket clubs, and rehabilitated real estate. In 1986 and 1987 he worked from 80 to 90 hours per week in his parents' real estate activity and in other business activities. His parents paid him about $30,000 in 1986 and $20,000 in 1987 for his services. During those years he also worked for Kathy Wilson Management Co. and Kathy Wilson individually. His total reported adjusted gross income was $43,000 for 1986 and $29,000 for 1987.

d. The D'Annunzios

David D'Annunzio, Mrs. Conti's father, was born in 1881 and died in 1960. Rose D'Annunzio, Mrs. Conti's mother, was born in 1881 and died in 1973. From about 1953 to 1966, petitioners and Mrs. Conti's mother lived together in Detroit, Michigan.

Alfred D'Annunzio, Mrs. Conti's brother, died in 1981 following an extended illness. He had $2,907 in Federal and State income tax refunds for 1981, all of which Mrs. Conti received. Alfred D'Annunzio bequeathed all of his property to Mrs. Conti. His property, except for cash and other personal property, was held jointly by himself and Mrs. Conti.

e. Lifestyle

Petitioners had personal living expenses including Federal income tax payments of $38,487.69 for 1986 and $22,658.29 for 1987. They received Social Security payments of $12,313 in 1986 and $13,459 in 1987. Their lifestyle was not lavish.

2. Petitioners' Bank and Brokerage Accounts

Petitioners maintained several bank and brokerage accounts. The bank accounts were at Bloomfield Savings & Loan Association, Standard Federal Bank, Sterling Federal Bank, Sterling Federal Savings & Loan Association, Comerica Bank, First America Bank, Manufacturers National Bank, National Bank of Detroit, and Michigan National Bank. The brokerage accounts were with Merrill Lynch and E.F. Hutton. Petitioners also had individual retirement accounts at Comerica Bank.

Mrs. Conti made at least the following deposits to their bank accounts in 1986 and 1987 (see appendix A):

All Deposits			Cash Deposits			Coin Deposits	
Number	Total	Average	Number	Total	Average	Number	Total
			Bloomfield Savings & Loan, 1986				
26	$137,772.81	$5,298.95	25	$ 47,550.00	$1,902.00	9	$2,170
			Standard Federal Bank, 1986				
14	78,023.96	5,573.14	14	30,100.00	2,150.00	6	1,882
			Sterling Federal Savings, 1986				
4	9,800.00	2,450.00	4	9,800.00	2,450.00	0	0
			Bloomfield Savings & Loan, 1987				
37	124,919.78	3,376.21	20	67,650.00	3,382.50	0	0
			Standard Federal Bank, 1987				
38	$201,286.95	5,297.03	33	85,125.00	2,579.55	8	2,200
			Sterling Federal Savings, 1987				
133	399,403.69	3,003.04	35	138,083.90	3,945.00	0	0

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Mrs. Conti and her brother had joint bank accounts with a $160,894.42 total balance when closed in 1981. As of June 27, 1980, Mrs. Conti and her brother jointly owned common stock which cost $72,391.

Petitioners had the following account balances in banks at the end of the years indicated:

Bank	1985	1986	1987
Bloomfield Savings	$ 78,400.39	$ 22,457.43	$ 40,454.90
Comerica	34,590.50	33,160.27	62,583.22
Standard Federal	[1]	13,690.66	32,069.51
Manufacturers National Bank	19,493.31	26,863.82	70,154.94
First America	21,621.64	[1]	59,584.61
Michigan National Bank	8,354.91	22,181.61	[1]
National Bank of Detroit	40,664.35	26,078.62	46,888.83
Sterling Federal Savings	[1]	3,722.74	2,387.02
Totals	$203,125.10	$148,155.15	$314,123.03

[1] Not in record.

Petitioners sold 1,734 shares of stock from 10 companies in 1982 for a $7,635 profit. Petitioners sold 406 shares of stock from two corporations in 1985 for a $10,900 profit. Petitioners invested $77,979 in 12 companies in 1985 and $26,047 in 7 companies in 1986.

3. Petitioner's Real Estate Business

Petitioners began investing in real property in the early 1980s at the suggestion of their son Mark. They bought, sold, rented, and renovated real estate. Mrs. Conti handled the banking activity for the business. Petitioners had an office suite on Adams Street with two rooms. The sign on the door said, "Edith J. Conti". They had four employees. Petitioners had business assets with costs of acquisition values on the last day of 1986 and 1987 as follows:

Business Assets	1986	1987
Phone	$640	$640
Furniture	25,221	25,221
Dump truck		15,547
Truck		8,135

Petitioners' real estate purchases and sales included the following:

Date	Address	Activity	Comments
Oct. 31, 1983	31491 Bellvine Birmingham, MI	purchase	$51,315.52 outstanding mortgage
Oct. 26, 1984	552 Hannah Birmingham, MI	purchase	assumed $64,000 mortgage
July 10, 1985	552 Hannah Birmingham, MI	sale	$8,123 gain
Aug. 26, 1985	399 Baldwin Birmingham, MI	purchase	
Feb. 7, 1986	399 Baldwin Birmingham, MI	sale	
N/A	745 Abbey Birmingham, MI	purchase	
Aug. 13, 1986	745 Abbey Birmingham, MI	sale	
June 12, 1986	887 Wimbleton Birmingham, MI	purchase	$96,250 mortgage
N/A	1231 Emmons Birmingham, MI	purchase	$29,500 mortgage
July 31, 1986	963 Woodward Birmingham, MI	purchase	$46,000 mortgage
Aug. 8, 1986	4891 Yorkshire Detroit, MI	sale	petitioners' residence
Oct. 16, 1986	480 Yarmouth Birmingham, MI	purchase	
Oct. 31, 1986	319 Henley Birmingham, MI	purchase	$317,500 mortgage
Nov. 14, 1986	Henley Birmingham, MI	purchase	unimproved lot
March 27, 1987	31660 Glencoe	sale	
May 22, 1987	2655 E. Maple Birmingham, MI	purchase	condominium
June 30, 1987	423 Totting Lane Birmingham, MI	purchase	demolished house and subdivided lots
Oct. 15, 1987	423 Totting Lane Birmingham, MI	sale	subdivided lots
N/A	600-602 Lincoln Birmingham, MI	purchase	

N/A = no date available.

The total cost of petitioners' real estate held on December 31, 1985, was $255,630; $1,177, 704 on December 31, 1986, and $1,279,704 on December 31, 1987. The total cost of real estate improvements made by petitioners was $65,712 on December 31, 1985, $186,927 on December 31, 1986, and $394,252 on December 31, 1987.

Petitioners' total mortgages payable were $48,872.17 on December 31, 1985, $461,330.34 on December 31, 1986, and $137,070.61 on December 31, 1987.

Mrs. Conti received $39,900 from the sale of a home at 13958 Parkgrove, Detroit, Michigan, that she held jointly with her mother and brother.

4. Petitioners' Net Worth as of December 31, 1985

The parties stipulated to the items in the net worth analysis, except for cash on hand. We find that petitioners' cash on had as of December 31, 1985, was $150,000 (as determined by respondent), and that they received no loans from Mark in 1986 and 1987. Petitioners' contentions to the contrary are discussed below. Adding Cash on hand of $150,000 (as determined by respondent) to the stipulation results in the following:

ASSETS	1985	1986	1987
Cash on hand	$150,000.00	$ 150,000.00	$ 150,000.00
Cash in bank	223,125.10	148,155.04	314,123.03
IRA's	9,000.00		2,250.00
Merrill Lynch:			
Cash	590.15	1.32	
CMA funds	74,306.50	55,105.00	14,475.00
CD Phila. Savings Fund	20,000.00		
CD Northwest Svgs.			50,000.00
Investments	77,979.00	26,047.00	
Real estate	225,630.00	1,177,704.00	1,279,704.00
Real estate improvements	65,712.00	186,927.00	394,252.00
Business assets		25,861.00	49,543.00
TOTAL ASSETS	$846,342.75	$1,769,800.36	$2,254,347.03

	1985	1986	1987
LIABILITIES			
Mortgages payable	$ 48,872.17	$ 461,330.34	$ 137,070.61
Accumulated depreciation	18,111.00	43,368.00	126,049.00
TOTAL LIABILITIES	$ 66,983.17	$ 504,698.34	$ 263,119.61
NET WORTH			
Less: prior year	$779,359.58	$1,265,102.02	$1,991,227.42
Net worth increase		779,359.58	1,265,102.02
Additions to net worth		485,742.44	726,125.40
Total net worth increase		38,487.69	151,419.29
Less: deductions		524,230.13	877,544.69
Corrected adjusted gross income		40,074.00	19,982.00
Adjusted gross income per return		484,156.13	857,562.69
Unidentified income		48,401.00	(94,316.00)
		$ 435,755.13	$ 951,878.69

On December 31, 1985, petitioners had cash of $100,000 in their home and $20,000 in a safety deposit box.

5. Petitioners' Income Tax Returns

The C.P.A. firm of Grey, Trepeck and Cohen, P.C., prepared petitioners' Federal income tax returns from 1981 through the years at issue. Their return for 1984 was prepared by Theodore Cohen, C.P.A. Their returns for 1985, 1986, and 1987 were prepared by Leonard A. Grey, C.P.A. (Mr. Grey).

Petitioners gave some schedules of income and expenses, closing documents for real estate transactions, check stubs, Forms W-2 and 1099, and brokerage statements to Mr. Grey to prepare petitioners' returns. Sales, income, rents, and gain from the real estate transactions were included in petitioners' income tax returns by Mr. Grey and accounted for in the years in issue.

Mrs. Conti wrote a $410 check to Grey & Trepeck, P.C., on May 13, 1987, with the memo, "taxes for 1986".

Petitioners reported that they received $166,786 in interest and $38,335 in dividends on their income tax returns from 1971 through 1985. They received taxable refunds from 1971 through 1985 totaling $16,109 and other income of $1,938.

Petitioners had a $12,000 nonbusiness bad debt in 1984.

6. The Audit

Revenue Agent Pamela Keysor conducted the audit in this case. She obtained a bachelor's degree in accounting in 1985 from Ferris State University, and she prepared corporate tax returns for a C.P.A. firm for 2 years. She was hired by the Internal Revenue Service (IRS) in September 1987 and underwent training for about 3 months. The Contis' case was one of her first auditing assignments. It was her first net worth case.

Ms. Keysor was not a certified public accountant as of the date of trial. She has taken the C.P.A. exam five times and has passed the practice and law portions, but has not passed the auditing and theory parts of the exam.

Ms. Keysor began to audit petitioners for 1986 and 1987 around March 1988. Mark Conti dealt with Mr. Grey, petitioners' representative, on behalf of petitioners during the audit. Mark Conti provided documentation to Mr. Grey. As a part of the audit, Ms. Keysor met with Mrs. Conti, Mark Conti, and Mr. Grey on April 18, 1988. Except for Mrs. Conti's attendance of the April 18, 1988, meeting, petitioners had no contact with Mr. Grey during their audit.

Ms. Keysor interviewed Mrs. Conti during the April 18 meeting. In that interview Mrs. Conti told Ms. Keysor that petitioners had about $100,000 cash at their residence and over $20,000 in a safe deposit box. Mrs. Conti stated that the cash was partly from a $200,000 to $250,000 gift from her mother and partly from a $300,000 inheritance from her brother. Ms. Keysor's handwritten notes state, "Taxpayer keeps large sum of cash on hand, ($150,000)."

Mrs. Conti did not say that the source of the cash was Mr. Conti's earnings from Ford and his military service, or loans from Mark Conti.

After meeting with Ms. Keysor on April 27, 1988, Mr. Grey met with Mark Conti to prepare petitioners' response to Ms. Keysor's questions. Mr. Grey told Mark Conti the amount of cash on hand that would be required to account for the net worth increase.

On May 23, 1988, Mr. Grey sent a letter to Ms. Keysor which stated that petitioners had the following cash on hand:

	Safety Deposit Boxes	House	Total Cash on Hand
Beginning of 1986	$300,000+	$150,000+	$450,000+
End of 1986	100,000+	175,000+	275,000+

Mark Conti, not petitioners, gave all of this information to Mr. Grey.

OPINION

1. Respondent's Determination Using the Net Worth Method

Respondent used the net worth method to determine petitioners' income for the years in issue. Under the net worth method, income is computed by determining a taxpayer's net worth (excess of assets at cost over liabilities) at the beginning and end of a year. The difference between the two figures is the increase in net worth. This

difference is increased by adding nondeductible expenditures, including living expenses, and by subtracting gifts, inheritances, loans, and the like. *Holland v. United States*, 348 U.S. 121, 125 (1954); *United States v. Giacalone*, 574 F.2d 328, 330-331 (6th Cir. 1978). An increase in a taxpayer's net worth, plus his nondeductible expenditures, less nontaxable receipts, may be considered taxable income. *Holland v. United States, supra.*

In a net worth case, respondent must: (1) Establish, with reasonable certainty, an opening net worth, and (2) either (a) show a likely income source, or (b) negate possible nontaxable income sources. *Holland v. United States, supra* at 132-138; *Smith v. Commissioner*, 91 T.C. 1049, 1059 (1988), affd. 926 F.2d 1470 (6th Cir. 1991); *Brooks v. Commissioner*, 82 T.C. 413, 431-432 (1984), affd. without published opinion 772 F.2d 910 (9th Cir. 1985). Petitioners argue that the determination is arbitrary because none of the *Holland* requirements have been met. We disagree.

a. Opening Net Worth

The taxpayer's net worth at the beginning of the taxable year is a key element in a net worth case. *Fuller v. Commissioner*, 313 F.2d 73, 77 (6th Cir. 1963), modifying T.C. Memo. 1961-262; *Brodella v. United States*, 184 F.2d 823, 825 (6th Cir. 1950). Petitioners contend that respondent's determination is arbitrary because of respondent's opening net worth figure. We disagree.

With the exception of cash on hand and loans from Mark, the parties agree as to the opening net worth for

each of the years in issue. Cash on hand is a part of the opening net worth. See *Estate of Phillips v. Commissioner*, 246 F.2d 209, 213 (5th Cir. 1957), revg. and remanding T.C. Memo. 1955-139.

Petitioners allege they had about an $800,000 cash hoard at the beginning of 1986, and about $550,000 in loans from Mark in 1986 and 1987. As discussed next, we conclude that these claims are implausible, inconsistent in significant ways with their previous statements to IRS agents and their own advisers, and uncorroborated by records.

b. Petitioners' Cash Hoard Claim

Respondent determined petitioners' opening net worth to be $150,000 based on an interview of Mrs. Conti by respondent's revenue agent. Petitioners argue that this determination is arbitrary and that respondent's revenue agent was unqualified and inexperienced. Respondent's revenue agent testified that Mrs. Conti told her that petitioners had $100,000 cash at home and $20,000 in a safety deposit box. Respondent's agent rounded up and approximated $150,000 as the amount of cash on hand. In essence, respondent's agent gave petitioners a $30,000 benefit of the doubt. We do not find that that makes the determination arbitrary, and we see no reason to respond separately to petitioners' attack on respondent's agent's qualifications.

At trial, petitioners and their son Mark testified that petitioners accumulated an $800,000 cash hoard over about 50 years. Petitioners allege that they had about

$800,000 in cash as of December 31, 1985, composed of personal savings, gifts, and inheritances. There is no documentation for these assertions. Petitioners offer no corroboration for their testimony on these points.

The objective evidence shows that Mrs. Conti made large cash deposits during the years in issue. She testified that she was very cautious and believed in depositing a small amount in a lot of banks. However, the objective evidence indicates the opposite is true. Petitioners had extensive investment activity from 1980 through 1985. This indicates that they were not as financially unsophisticated as they wish to appear. Petitioners give no persuasive reason why they would forgo earning interest on the massive claimed cash hoard, and then suddenly invest it. Petitioners' frequent bank deposit activity of several thousand dollars during the years at issue is also inconsistent with their claimed cash hoard; regular weekly deposits are more likely to be from a regular source of income than from a withdrawal of a cash hoard of currency savings accumulated over a lifetime. Mrs. Conti's explanation that she deposited cash on a weekly basis because it was as the business needed it is not supported by the documentary evidence.

Petitioners placed mortgages on real property they owned while they allegedly had their cash hoard. They also allege borrowing money from Mark. Evidence of borrowing supports an inference that they had no cash hoard because a cash hoard negates the necessity to borrow. *Thomas v. Commissioner,* 223 F.2d 83, 88 (6th Cir. 1955), revg. and remanding a Memorandum Opinion of this Court dated Oct. 30, 1953; see *Holland v. United States,* 348 U.S. 121, 133 (1954) (taxpayers would not have lost

possession of their cafe and furniture and accumulated unpaid debts if they had a cash hoard of $104,000).

Petitioners have increased the amount of their claimed cash hoard throughout the life of this case. In the initial examination interview, Mrs. Conti stated that petitioners had $100,000 in cash at their home and $20,000 in a safe deposit box. After reviewing respondent's net worth analysis, petitioners' accountant sent respondent a letter stating that petitioners had $450,000 cash on hand at the beginning of 1986. When they filed their petition in this case, petitioners claimed that they had $800,000 in cash in the beginning of 1986.

As to the source of their alleged cash hoard, petitioners suggest that about $800,000 came from personal savings, gifts from Mrs. Conti's mother, and an inheritance from Mrs. Conti's brother, and about $550,000 came from loans from Mark during 1986 and 1987. Petitioners assert that the sources of the cash hoard that they accumulated include: Mr. Conti's sale of Nazi weapons during World War II; gifts from Rosa D'Annunzio, who petitioners said accumulated cash from selling wine and beer during Prohibition; savings from 16 years with few or no expenses while living with Mrs. Conti's mother; and various gifts and inheritances from family members. Petitioners allege that they obtained two beige fireproof metal boxes from Alfred D'Annunzio in 1980, and that they hid cash in a green-colored metal box that they got from Mrs. Conti's mother. Petitioners testified to the dimensions of each of those containers. They claimed that Mrs. Conti's family accumulated large amounts of cash, from no substantiated source, and without any records.

We find petitioners' claims to be improbable and unbelievable.

Other than petitioners' testimony, there is no evidence of their personal savings. Gifts from Mrs. Conti's mother are likewise uncorroborated. Moreover, it seems unlikely that either Mrs. Conti's mother or brother had the ability to provide funds as claimed. Most of the events alleged to be the source of the cash hoard occurred long ago. The events are not susceptible to being checked. Mrs. Conti's mother and brother and Mrs. Conti's father are deceased. Mrs. Conti's mother allegedly dealt largely in cash and allegedly purchased a house with cash. Presumably the sale of beer and wine during Prohibition was in cash. There is no documentary evidence of these nontaxable funds, inheritances, or gifts. As discussed below, we believe that the claimed loans from Mark are a fabricated defense. Overall, we have found petitioners' and Mark's testimony to be unbelievable, improbable, and unreasonable.

Petitioners offered no credible, independent support for any of their claims. Petitioners did not offer to respondent any evidence which respondent may have failed to investigate as leads. A taxpayer cannot complain about the sufficiency of an investigation where he has offered no leads. *United States v. Penosi*, 452 F.2d 217, 220 (5th Cir. 1971); *Blackwell v. United States*, 244 F.2d 423, 429 (8th Cir. 1957).

Petitioners argue that this case is like *Goodman v. Commissioner*, T.C. Memo. 1961-201. We disagree. In that case we found that the Commissioner's opening net

worth for the taxpayers was not sound because the Commissioner failed to include a substantial amount of undeposited cash which the taxpayer had. In the present case, respondent included undeposited cash of $150,000 and we have found that petitioners have not proven that they had any more undeposited cash. Thus, *Goodman* does not assist petitioners.

c. Loans From Mark

Petitioners claim that their son Mark Conti lent them $124,947.50 in 1986 and $450,077.58 in 1987. At trial Mark Conti produced a schedule that he prepared shortly before trial showing loans to his parents of $124,947.50 in 1986 and $457,077.58 in 1987 for a total of $582,025.80. He testified that he obtained the money from his savings of about $75,000, a divorce settlement of $170,000, and loans he received from others from 1981 through 1984. He also testified that only a small part of the loan to his parents came from his earnings. He stated that the loans to his parents had no interest rate and no due date. He said that he lent currency and checks to his parents but primarily currency.

Mark Conti testified that from 1980 through 1985 people lent him approximately $600,000 or $700,000. He stated that Oakdale Racquet Club lent him $10,000 to $15,000 from 1981 to 1984. Mark Conti testified that he received a loan in 1983 from Hybernia Bank (2 percent over prime payable on demand) and successive loans from 1981 through 1983 from the Bank of the Commonwealth (3 percent over prime payable in 2 or 3 years). He testified that both Hybernia Bank and the Bank of the

Commonwealth took a personal guarantee from him; thus there was no collateral for those loans. He testified that he was earning between $20,000 and $30,000 per year at that time. He stated that he made some installment payments, but the loans had not been repaid.

Mark Conti testified that he invested the money lent to him, and that he removed money from the investments beginning in 1983. He invested in tennis clubs which were not successful. Mark Conti explained that his investment was not lost because he recovered cash from the sale of assets.

Mark Conti testified that he made one small loan to his parents in the 1970s.

Mark Conti's testimony about his purported loans to petitioners is implausible and incredible. Petitioners did not mention any loans from Mark Conti during the audit; they first claimed the existence of the loans at trial. We are not convinced that petitioners received loans from Mark Conti. There are no supporting documents, interest, or due dates for the purported loans. Petitioners argue that it is normal not to have such formalities for intra-family loans. We disagree. The amounts of these purported loans make it unlikely that the loans would be undocumented.

d. Petitioners' Experts

Petitioners called two expert witnesses. Petitioners' expert Chauncy Tuttle investigated petitioners' financial affairs on their behalf before trial. His report simply assumes that petitioners' cash hoard claim is true. He

testified that petitioners had not told him about any loans from Mark. This undermines petitioners' claim that they received loans from Mark. It is at best unlikely that petitioners would not inform their own expert of such a significant part of their financial situation.

Petitioners' expert William Bangela prepared a schedule showing a source and application of petitioners' funds from January 1, 1937, to December 31, 1985. His report does not assist us in deciding the extent of cash on hand on December 31, 1985, because he simply assumed that the cash hoard figures given to him by petitioners were true. For example, based simply on petitioners' claims, the analysis assumes cash on hand as of December 31, 1965, of $273,500, cash from Alfred D'Annunzio of $300,000, and various cash gifts from Mrs. Conti's mother. His analysis was based primarily on total assets such as cash in banks, stock, life insurance, and real property over the entire lifetime of both petitioners. Mr. Bangela admitted that his analysis/report only shows potential rather than actual cash on hand. He also admitted that petitioners' income was relatively high but he used the Bureau of Labor Statistics low budget for estimating expenses, thus increasing potential cash on hand.

e. Opening Net Worth – Conclusion

A taxpayer's unimpeached, competent, and relevant testimony "may not be arbitrarily discredited and disregarded" by the Court. *Loesch & Green Construction Co. v. Commissioner,* 211 F.2d 210, 212 (6th Cir. 1954), revg. a Memorandum Opinion of this Court dated Dec. 11, 1952.

However, we are not required to accept implausible testimony, particularly in the absence of persuasive corroborating evidence. See *Estate of DeNiro v. Commissioner*, 746 F.2d 327, 330-331 (6th Cir. 1984), affg. in part and remanding in part T.C. Memo. 1982-497; *Lovell & Hart, Inc. v. Commissioner*, 456 F.2d 145, 148 (6th Cir. 1972), affg. T.C. Memo. 1970-335; *Geiger v. Commissioner*, 440 F.2d 688, 689 (9th Cir. 1971), affg. per curiam T.C. Memo. 1969-159; *Urban Redevelopment Corp. v. Commissioner*, 294 F.2d 328, 332 (4th Cir. 1961), affg. 34 T.C. 845 (1960). The Court may consider circumstantial evidence when deciding the amount of the taxpayer's funds from nontaxable sources. *Estate of Mercure v. Commissioner*, 448 F.2d 922, 924 (6th Cir. 1971), affg. T.C. Memo. 1969-206; *Friedman v. Commissioner*, 421 F.2d 658, 659 (6th Cir. 1970), affg. T.C. Memo. 1968-145. We are cognizant of the line of cases in the Sixth Circuit holding that where the taxpayer is confronted with proving nonreceipt of income determined by respondent to be attributable to him, the court should apply a lesser burden to the taxpayer than is normally applied in tax cases. *United States v. Walton*, 909 F.2d 915, 918-919 (6th Cir. 1990); *Weir v. Commissioner*, 283 F.2d 675, 679 (6th Cir. 1960), revg. T.C. Memo. 1958-158; *Harp v. Commissioner*, 263 F.2d 139, 141 (6th Cir. 1959), affg. in part and revg. in part T.C. Memo. 1957-105. Even applying a lesser burden of proof, we do not believe petitioners.

Mrs. Conti's testimony was unconvincing. She was at times evasive, self-serving, inconsistent, and selectively forgetful. Mark Conti's testimony was also unconvincing. His testimony was contrived and implausible. The analysis of their experts did little or nothing to validate

petitioners' cash hoard and loan claims. We conclude that as of December 31, 1985, petitioners did not have a cash hoard in excess of $150,000 or any loans from Mark.

f. Leads and Likely Source of Unreported Taxable Income

Respondent must also establish that a reasonable investigation of leads negating possible sources of nontaxable income has been conducted. *Holland v. United States*, 348 U.S. 121, 135-138 (1954); *Smith v. Commissioner*, 91 T.C. 1049, 1059 (1988), affd. 926 F.2d 1470 (6th Cir. 1991); *Brooks v. Commissioner*, 82 T.C. 413, 431-432 (1984), affd. without published opinion 772 F.2d 910 (9th Cir. 1985). Respondent has met this burden because we have rejected petitioners' cash hoard and loan claims.

Respondent has not shown a likely source of petitioners' unreported taxable income. However, proof of a likely source of income is not a prerequisite to use of the net worth method when all possible sources of nontaxable income are negated. *United States v. Massei*, 355 U.S. 595 (1958); *Foster v. Commissioner*, 487 F.2d 902, 903 (6th Cir. 1973), affg. T.C. Memo. 1972-188.

We note that respondent has the burden of establishing by a preponderance of the evidence the additional unreported income for 1986 asserted after the petition was filed in this case. Rule 142(a); *Estate of Schneider v. Commissioner*, 29 T.C. 940, 956 (1958); *Beck Chemical Equipment Corp. v. Commissioner*, 27 T.C. 840, 856 (1957). Since the parties stipulated petitioners' net worth, except for their cash hoard and loan claims which we have rejected, we are persuaded of the additional unreported income.

2. Deductions for Tax Return Preparation Fees and Sales Taxes

Respondent disallowed petitioners' claimed $410 tax return preparation fee deduction for 1987 because of the 2-percent floor for miscellaneous deductions. Sec. 67. Petitioners' response to this argument is that the 2-percent floor is not a problem if they establish that they had an $800,000 cash hoard and $550,000 in loans from Mark. As is discussed above, we reject petitioners' position. Accordingly, petitioners may not deduct the $410 return preparation fee for 1987.

Respondent disallowed $5,047 of petitioners' claimed sales tax deduction for lack of substantiation. At trial, Mr. Grey testified that either Mrs. Conti or Mark Conti gave him a lump-sum sales tax deduction figure without any underlying documentation. Petitioners do not contest this issue on brief. Accordingly, we treat this issue as conceded.[1] See Rule 151(e)(4) and (5); *Petzoldt v. Commissioner*, 92 T.C. 661, 683 (1989); *Money v. Commissioner*, 89 T.C. 46, 48 (1987).

3. Income From Sales of Residence

Respondent determined that petitioners had $893 in additional income in 1986 as gain from the sale of their

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[1] We note that in the opening brief respondent proposed an ultimate finding of fact that petitioners are entitled to additional rental depreciation of $5,047 for 1986. Petitioners did not object to this finding. However, we conclude that petitioners are entitled to $5,369 disallowed in the notice of deficiency as additional rental depreciation.

residence. Petitioners do not argue this issue on brief. Consequently, we treat this issue as being conceded. See Rule 151(e)(4) and (5); *Petzoldt v. Commissioner, supra; Money v. Commissioner, supra.*

4. Fraud Under Section 6653(b)

Respondent determined that petitioners were liable for the fraud additions to tax under section 6653(b). Petitioners allege that respondent failed to prove fraud by clear and convincing evidence. We disagree.

The existence of fraud is a question of fact to be resolved by consideration of the entire record. *Parks v. Commissioner,* 94 T.C. 654, 660 (1990); *Gajewski v. Commissioner,* 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). Respondent has the burden of proving fraud by clear and convincing evidence. Sec. 7454(a); Rule 142(b); *Parks v. Commissioner, supra.*

First, respondent must prove the existence of an underpayment. *Parks v. Commissioner, supra.* For fraud purposes, respondent may not rely upon the taxpayer's failure to carry the burden of proof as to the underlying deficiency. *Parks v. Commissioner, supra* at 660-661; *Petzoldt v. Commissioner, supra* at 700; *Estate of Beck v. Commissioner,* 56 T.C. 297, 363 (1971). Second, respondent must show that the taxpayer intended to evade taxes by conduct intended to conceal, mislead, or otherwise prevent tax collection. *Stoltzfus v. United States,* 398 F.2d 1002, 1004 (3d Cir. 1968); *Parks v. Commissioner, supra* at 661; *Rowles v. Commissioner,* 80 T.C. 1111 (1983).

a. Underpayment

Respondent may prove an underpayment by proving a likely source of the unreported income, *Holland v. United States*, 348 U.S. 121 (1954); *Parks v. Commissioner, supra; Nicholas v. Commissioner*, 70 T.C. 1057 (1978); or where the taxpayer alleges a nontaxable source, by disproving the specific nontaxable source so alleged, *United States v. Massei*, 355 U.S. 595 (1958); *Kramer v. Commissioner*, 389 F.2d 236, 239 (7th Cir. 1968), affg. T.C. Memo. 1966-234; *Parks v. Commissioner, supra.*

Since no likely source of petitioners' unreported income has been shown, respondent must disprove petitioners' allegation of a cash hoard and loans. Respondent may disprove the alleged nontaxable source of income by showing that the reconstruction of income is accurate and that petitioners' allegation of a cash hoard and loans is inconsistent, implausible, and not supported by the objective evidence in the record. *Parks v. Commissioner, supra.*

Petitioners contend that respondent's determination that petitioners had opening cash on hand of $150,000 is incorrect. We have rejected this view. Petitioners also argue that the initial income reconstruction was inaccurate as shown by respondent's changes to the initial determination in the amended answer and again on brief. The refinements to the initial income reconstruction are, in our opinion, the result of changes in information available to respondent, primarily from third parties. Additionally, there was a substantial increase in petitioners' net worth in 1986 and 1987. Petitioners' only explanation for this increase was the claimed cash hoard and loans from Mark. We rejected the cash hoard and loan theories.

Accordingly, we conclude that respondent has proved an underpayment. *United States v. Massei, supra; Kramer v. Commissioner, supra; Parks v. Commissioner, supra.*

b. Fraudulent Intent

Respondent must also prove by clear and convincing evidence that petitioners had the requisite fraudulent intent. *Parks v. Commissioner, supra* at 664. For purposes of section 6653(b), fraud means "actual, intentional wrongdoing," *Mitchell v. Commissioner,* 118 F.2d 308, 310 (5th Cir. 1941), revg. 40 B.T.A. 424 (1939); or the intentional commission of an act or acts for the specific purpose of evading a tax believed to be owing, *Webb v. Commissioner,* 394 F.2d 366, 377 (5th Cir. 1968), affg. T.C. Memo. 1966-81.

The courts have developed a number of objective indicators or "badges" of fraud. *Recklitis v. Commissioner,* 91 T.C. 874, 910 (1988). Examples of the "badges of fraud" present in this case are: (1) Large understatements of income, (2) inadequate records, (3) implausible or inconsistent explanations of behavior, (4) concealment of assets, and (5) dealings in cash. *Bradford v. Commissioner,* 796 F.2d 303, 307-308 (9th Cir. 1986), affg. T.C. Memo. 1984-601.

Petitioners' large underpayments are unexplained. We have rejected their theories of a large cash hoard and loans from Mark as incredible. We do not believe the purported sources of the cash hoard, including sales of Nazi weapons during World War II, bootlegging income, and savings from a purported 16 years of expense-free living with Mrs. Conti's mother. We do not believe that

Mark made over $500,000 in interest-free loans to petitioners when he took out loans on which he had to pay interest. Large unexplained discrepancies between petitioners' actual net income and the net income reported on their tax returns are evidence of fraud. *Stone v. Commissioner,* 56 T.C. 213, 214 (1971).

Petitioners had unreported income in both of the years in issue. Fraud may be inferred from repeated understatements in successive years when coupled with other circumstances showing an intent to conceal or misstate taxable income. *Patton v. Commissioner,* 799 F.2d 166, 171 (5th Cir. 1986), affg. T.C. Memo. 1985-148; *Anderson v. Commissioner,* 250 F.2d 242, 250 (5th Cir. 1957), affg. on this issue T.C. Memo. 1956-178.

Petitioners did not maintain any records of their alleged cash hoard or loans from Mark. A taxpayer's failure to maintain accurate and complete records, when coupled with other indicia, supports a finding of fraud, as does a taxpayer's failure to supply his bookkeeper or accountant with all data necessary to maintain complete and accurate records. *Merritt v. Commissioner,* 301 F.2d 484, 487 (5th Cir. 1962), affg. T.C. Memo. 1959-172; *Reaves v. Commissioner,* 295 F.2d 336, 338 (5th Cir. 1961), affg. 31 T.C. 690 (1958). Taxpayers' failure to supply complete information about their income and expenses to their tax return preparer is further evidence of fraudulent intent. *Korecky v. Commissioner,* 781 F.2d 1566, 1569 (11th Cir. 1986), affg. per curiam T.C. Memo. 1985-63.

Petitioners maintained several bank and brokerage accounts. In 1986 Mrs. Conti made at least 43 cash deposits totaling $87,450. Her average cash deposit in

1986 was over $2,000. Mrs. Conti made at least 15 coin deposits in 1986 totaling over $4,000. In 1987 Mr. Conti made at least 88 cash deposits totaling over $290,000. Her average cash deposit in 1987 was over $3,300. Petitioners' explanation that the cash and coin deposits came from their $800,000 cash hoard or $550,000 of loans from Mark is not believable.

We believe petitioners are concealing the source of the cash. The intent to conceal or mislead may be inferred from a pattern of conduct. See *Spies v. United States*, 317 U.S. 492, 499 (1943). A pattern of consistent underreporting of income for a number of years, especially when accompanied by other circumstances showing intent to conceal, such as Mrs. Conti's banking pattern of conduct, is strong evidence of fraud. *Holland v. United States*, 348 U.S. 121, 137-139 (1954); *Estate of Mazzoni v. Commissioner*, 451 F.2d 197, 202 (3d Cir. 1971), affg. T.C. Memo. 1970-37; *Foster v. Commissioner*, 391 F.2d 727, 733 (4th Cir. 1968), affg. on this issue T.C. Memo. 1965-246; *Petzoldt v. Commissioner*, 92 T.C. 661, 700 (1989); *Otsuke v. Commissioner*, 53 T.C. 96, 106 (1969).

Petitioners increased the amount that they claimed as their cash hoard as the IRS examination and this case progressed from $120,000 at the initial audit interview, to $450,000 in a letter from Mr. Grey, to $800,000 during this litigation. They also did not claim they received $550,000 in loans from Mark until trial. Thus, their oral and written claims as to cash on hand were false and inconsistent. Fraud may be inferred where the taxpayer makes false and inconsistent statements to revenue agents, *Grosshandler v. Commissioner*, 75 T.C. 1, 20 (1980), or files

false documents, *Stephenson v. Commissioner*, 79 T.C. 995, 1007 (1982), affd. 748 F.2d 331 (6th Cir. 1984).

Finally, petitioners had extensive unexplained dealings in currency which indicate fraud. *Bradford v. Commissioner*, 796 F.2d 303, 307-308 (9th Cir. 1986), affg. T.C. Memo. 1984-601.

We conclude that respondent has proven fraud by clear and convincing evidence. Accordingly, we hold that petitioners are liable for the additions to tax for fraud under section 6653(b).

5. Substantial Understatement of Income Tax Under Section 6661

Respondent determined that petitioners are liable for the addition to tax under section 6661. Section 6661(a) imposes an addition to tax of 25 percent of the amount of any underpayment attributable to a substantial understatement of income tax for a taxable year. A substantial understatement is one which exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. Sec. 6661(b). If petitioners' understatement of income is substantial within the meaning of section 6661(b)(1), they are liable for the section 6661 addition unless the understatement can be reduced under the exceptions contained in section 6661(b)(2)(B).

By either test of section 6661(b), petitioners' understatement is a substantial understatement. Petitioners have no authority for their failure to report their cash income, nor did they disclose any facts pertaining to such income on their returns or in a statement attached to their

returns. Therefore, the addition cannot be reduced through application of the provisions of section 6661(b)(2)(B). We hold that petitioners are liable for the additions to tax under section 6661.

To reflect concessions and the foregoing,

Decision will be entered under Rule 155.

APPENDIX

N/A = no date available.

Bloomfield Savings & Loan # 450323-6, for 1986

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
January 8	$ 1,747.83	$ 550	$ 100
January 17	2,000.00	2,000	0
January 17	3,210.67	900	0
January 21	5,100.00	2,600	0
February 3	3,426.66	2,000	200
February N/A	6,177.36	1,300	0
March 3	3,875.98	600	110
April 4	2,558.09	0	0
April 11	7,210.75	1,500	200
April 22	2,000.00	2,000	0
May 7	2,517.94	1,500	100
May N/A	9,661.86	1,600	0
June 11	2,000.00	2,000	0
June 17	13,000.00	3,000	0
June 30	2,911.46	2,500	0
July 3	3,994.94	1,000	0
July 21	4,500.00	4,500	0
July 28	8,061.16	2,500	360
August 1	3,930.46	1,000	200
August 11	29,457.11	3,000	0
August 13	2,000.00	2,000	0
August N/A	2,629.44	2,000	0
August 21	4,000.00	1,600	0
August 25	6,083.16	2,000	0
August 2	2,717.94	1,400	400
September 22	3,000.00	2,500	500
Totals	$137,772.81	$47,550	$2,170

Standard Federal Savings #041-500-4457, for 1986

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
September 10	$3,027.94	$2,000	$ 0
September 16	2,620.00	1,000	250
September 24	2,500.00	2,000	500
September 26	5,000.00	2,000	0
September 29	7,000.00	2,000	0
October 8	9,082.09	2,000	400
October 9	2,199.42	1,000	132
October 23	7,886.12	2,000	0
October 28	4,651.92	3,000	0
November 4	5,015.09	3,000	0

November 10	$ 5,350.00	$4,000	$300
November 11	2,613.37	2,600	0
December 4	3,877.00	1,500	300
December 26	17,201.01	2,000	0
Totals	$78,023.96	$30,100	$1,882

Sterling Savings #0-02-60-150581, for 1986

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
October 27	$4,000	$4,000	$0
November 24	2,000	2,000	0
December 12	1,500	1,500	0
December 29	2,300	2,300	0
Totals	$9,800	$9,800	$0

Bloomfield Savings & Loan #10-01-040074-7, for 1987

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
February 4	$ 850.00	$ 0	$0
February 5	2,600.00	0	0
February 24	425.00	0	0
February 24	4,674.00	0	0
February 27	2,526.00	0	0
March 2	850.00	0	0
March 4	1,040.00	0	0
March 4	1,500.00	0	0
Unknown date	50.00	0	0
March 19	2,000.00	0	0
March N/A	3,450.00	0	0
April 15	1,040.00	0	0
April 23	2,033.00	0	0
April 29	3,450.00	0	0
May 11	1,040.00	0	0
May 26	4,000.00	4,000	0
May 28	6,100.00	3,500	0
June 1	4,425.00	3,500	0
June 3	5,000.00	3,000	0
June 4	3,000.00	3,000	0
June 8	4,540.00	3,500	0
June 11	3,500.00	3,500	0
June 18	4,500.00	4,500	0
June 24	3,500.00	3,500	0
June 25	5,000.00	5,000	0
June 29	4,600.00	2,000	0

June 29	$ 5,040.00	$ 4,000	$0
July 1	2,000.00	0	0
July 14	4,000.00	4,000	0
Totals	$ 86,733.00	$47,000	$0
	38,186.78	20,650	
	$124,919.78	$67,650	

Bloomfield Savings & Loan # 03-02-0590431-3, for 1987

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
January 21	$ 3,500.00	$ 3,500	$0
February 10	2,750.00	2,750	0
March 13	2,400.00	2,400	0
May 13	3,600.00	3,600	0
May 18	2,500.00	2,500	0
September 23	3,500.00	3,500	0
October 30	4,900.00	2,400	0
November 23	15,036.78	0	0
Totals	$38,186.78	$20,650	$0

Standard Federal Savings # 041-500-4457, for 1987

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
January 5	$4,189.00	$2,000	$300
January 7	4,640.49	2,500	200
January 15	6,290.87	3,500	0
January 21	3,146.73	2,500	0
January 28	2,809.98	2,300	0
February 3	5,630.00	2,500	130
February 5	3,275.49	2,000	0
February 10	4,050.00	3,000	0
February 13	13,383.78	3,825	0
February 24	15,881.61	3,000	0
March 4	3,000.00[2]	2,000	0
March 17	2,708.77	2,000	200
March 27	3,877.80	3,000	0
April 2	4,969.00	1,000	0
April 15	3,398.00	3,000	0
April 22	3,874.52	3,200	0
April 30	13,151.00	3,000	0
May 4	3,967.00	2,000	0
May N/A	2,597.30	2,000	0

[2]This amount was illegible and may exceed $3,000.

May 13	$ 2,538.70	$ 2,000	$ 0
May 15	3,772.00	3,400	270
May 21	2,350.00	2,000	0
May 26	10,110.00	4,000	0
June 3	3,105.00	2,000	0
June 5	3,868.77	3,000	0
June 11	15,123.00	4,000	0
June N/A	1,926.43	1,400	0
July 8	5,265.93	3,000	0
July 13	3,500.00	3,000	500
July 17	2,965.36	2,000	200
July 24	5,223.46	2,000	400
August 14	5,530.90	4,000	0
September 5	15,361.75	0	0
September 14	2,984.55	1,000	0
September 23	6,154.00	0	0
September 30	4,162.76	0	0
October N/A	2,500.00	0	0
October N/A	3,000.00	0	0
Totals	$204,283.95	$85,125	$2,200

Sterling Savings # 0-02-60-150581, for 1987

Deposit Date	Total Deposit	Cash Deposit	Coin Deposit
January 13	$2,000.00	$2,000	$0
February 25	2,000.00	2,000	0
April 25	2,000.00	2,000	0
May 14	2,000.00	2,000	0
July 1	1,900.00	1,900	0
July 14	6,935.00	6,935	0
July 27	414.34	0	0
July 30	6,757.95	0	0
July 30	2,600.00	0	0
July 30	828.80	0	0
July 30	491.00	0	0
August 6	102.00	0	0
August 6	2,000.00	0	0
August 6	1,040.00	0	0
August 6	11,524.92	0	0
August 10	5,100.00	5,100	0
August 10	1,128.95	0	0
August 11	5,000.00	5,000	0
August 12	6,000.00	6,000	0
August 13	4,000.00	4,000	0
August 13	1,530.90	1,530.90	0
August 14	10,000.00	0	0
August 14	2,000.00	2,000	0
August 17	3,000.00	3,000	0
August 21	7,000.00	7,000	0
August 21	75.00	0	0

August 21	$ 18.00	$ 0	$0
August 22	5,000.00	5,000	0
August 24	500.00	0	0
August 24	6,000.00	6,000	0
August 25	6,510.00	6,510	0
August 26	5,000.00	5,000	0
August 26	950.00	0	0
August 26	1,525.00	0	0
August 27	20.00	0	0
August 27	666.00	0	0
August 27	1,462.50	0	0
August 31	1,500.00	1,500	0
August 31	2,600.00	0	0
September 2	6,000.00	6,000	0
September 3	6,000.00	6,000	0
September 3	625.00	0	0
September 5	3,143.00	3,143	0
September 5	2,000.00	0	0
September 5	317.66	0	0
September 5	40.00	0	0
September 9	5,000.00	5,000	0
September 10	6,500.00	6,500	0
September 11	3,000.00	3,000	0
September 14	8.00	0	0
September 14	99.84	0	0
September 14	75.00	0	0
September 14	88.92	0	0
September 16	4,525.00	4,525	0
September 17	7,000.00	7,000	0
September 17	1,782.54	0	0
September 18	2,000.00	2,000	0
September 18	196.12	0	0
September 21	628.91	0	0
September 21	445.63	0	0
September 30	25.60	0	0
September 30	2.00	0	0
September 30	625.00	0	0
September 30	2,600.00	0	0
September 30	30.00	0	0
October 2	2,000.00	0	0
October 2	97.53	0	0
October 6	50,774.65	0	0
October 6	589.81	0	0
October 6	950.00	0	0
October 13	30.00	0	0
October 13	45.00	0	0
October 13	203.50	0	0
October 13	26.32	0	0
October 21	71,933.51	0	0
October 22	11,000.00	0	0
October 27	2,600.00	0	0

October 27	$7,000.00	$7,000	$0
October 27	45.82	0	0
October 27	83.67	0	0
October 29	600.00	0	0
October 29	20,000.00	0	0
October 30	2,000.00	0	0
November 3	1,040.00	1,040	0
November 3	950.00	0	0
November 3	20,000.00	0	0
November 9	39.33	0	0
November 9	50.00	0	0
November 9	40.00	0	0
November 9	80.00	0	0
November 12	81.00	0	0
November 12	75.88	0	0
November 12	1,094.81	0	0
November 12	20.00	0	0
November 16	1,200.00	0	0
November 16	65.75	0	0
November 16	24.00	0	0
November 25	800.00	800	0
November 25	950.00	0	0
November 25	40.00	0	0
November 25	2,000.00	0	0
November 25	325.00	0	0
November 25	500.00	0	0
November 25	33.73	0	0
November 25	2,500.00	0	0
November 30	8.81	0	0
November 30	250.00	0	0
November 30	303.75	0	0
November 30	1,250.00	0	0
November 30	65.75	0	0
December 3	1,040.00	0	0
December 3	300.00	0	0
December 3	20.00	0	0
December 8	1,600.00	1,600	0
December 9	1,500.00	0	0
December 9	2,600.00	0	0
December 17	300.00	0	0
December 17	12.00	0	0
December 17	116.25	0	0
December 21	10.00	0	0
December 21	6.75	0	0
December 21	5,000.00	5,000	0
December 21	47.18	0	0
December 21	674.35	0	0
December 21	85.00	0	0
December 22	4,000.00	4,000	0
December 22	374.00	0	0
December 22	139.35	0	0

December 29	$ 1,500.00	$ 0	$0
December 29	1,807.61	0	0
December 29	365.00	0	0
December 30	1,000.00	1,000	0
December 30	1,200.00	0	0
Totals	$399,403.69	$138,083.90	$0

99 T.C. No. 20

UNITED STATES TAX COURT

GUILIO J. AND EDITH CONTI, Petitioners *v.* COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 15131-90. Filed September 29, 1992.

To corroborate a cash hoard claim, Ps offered into evidence the results of polygraph tests which were administered to them unilaterally, without notice to respondent.

Held: Results of petitioners' polygraph tests are inadmissible.

Mark C. Pierce, Robert B. Pierce, and *Paul T. Mengel,* for petitioners.

Dennis C. Driscoll, for respondent.

COLVIN, *Judge*: This case is before us on petitioners' offer into evidence of results of polygraph tests and respondent's objection thereto. Both parties called expert witnesses relating to whether polygraphy is generally accepted by the relevant scientific community. *Frye v. United States,* 293 F. 1013 (D.C. Cir. 1923).[1] Admission of

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[1] This Court has not previously considered the admissibility of polygraph examination results where taxpayers have attempted to show that they meet the criteria in *Frye v. United States,* 293 F.2d 1013 (D.C. Cir. 1923). In *Malandro v. Commissioner,* T.C. Memo. 1989-135, the taxpayer did not present any evidence showing whether polygraphy was generally accepted by the relevant scientific community. In *Rossmann v. Commissioner,* T.C. Memo. 1984-231, we ruled that certain testimony and documentary evidence regarding a polygraph test administered to the taxpayers was inadmissible. In *Grosshandler v. Commissioner,* 75 T.C. 1, 14-17 (1980), we noted that hypnosis was like

the polygraph examination results was taken under advisement to permit briefing by the parties.

Respondent determined deficiencies of $116,410.57 for 1986 and $390,227.28 for 1987, and additions to tax for fraud under section 6653(b) and substantial understatement of income tax under section 6661.

Respondent determined petitioners had a $150,000 cash hoard as of December 31, 1985. Petitioners claim that the results of polygraph tests administered to each of them corroborate their claim that they had an $800,000 cash hoard.

In this opinion we decide whether the results of polygraph tests administered to petitioners without notice to respondent are admissible. We hold they are not. We will decide the remaining issues in the case by separate opinion.

Unless otherwise provided, all section references are to the Internal Revenue Code as amended for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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polygraphy. In *Parker v. Commissioner*, T.C. Memo. 1976-225, we considered the admissibility of a polygraph examination. However, we found the issue to be moot because we found the taxpayer to be a credible witness. In several other cases, polygraphy was mentioned, but admissibility of examination results was not an issue. E.g., *National Home Products, Inc. v. Commissioner*, 71 T.C. 501 (1979) (conspirators refused to take polygraph tests); *Barrier v. Commissioner*, T.C. Memo. 1983-258 (taxpayer claimed a polygraph examination was given to an employee accused of embezzling from taxpayer); Estate of *Vella v. Commissioner*, T.C. Memo. 1982-73 (polygraph test was administered to a witness); *Reno Turf Club, Inc. v. Commissioner*, T.C. Memo. 1979-381 (polygraph of employees).

FINDINGS OF FACT

Some of the facts have been stipulated and are so found.

1. Petitioners and Their Family

Petitioners are husband and wife who resided in Birmingham, Michigan, when the petition was filed. Mr. Conti worked for Ford Motor Company for over 48 years, retiring in 1985. Mrs. Conti is a high school graduate. She handled the family finances, including banking. During the years in issue, petitioners bought, renovated, and sold real estate.

2. Polygraphy Generally

Petitioners offered into evidence results of polygraph examinations in an attempt to corroborate their cash hoard claim.

A polygraph examination measures the examinee's physiological reactions to questions. It measures respiration, perspiration, and heartbeat. The polygraph instrument has a pneumograph which measures respiration, galvanometer which measures skin's resistance to electricity, and a cardiosphygmograph which measures a combination of blood volume, blood pressure, and heart rate.

Respiration is recorded using two rubber tubes around the upper and lower body. Respiration is measured on both the upper and lower body because people breath [sic] differently. Resistance to electricity in the skin is measured by placing electrodes on two finger tips and passing a small electrical current through the fingers.

Cardiovascular activity is measured by using a blood pressure cuff.

These measures are simultaneously recorded by pens on a moving paper chart. The examiner marks the chart to indicate when a question has been asked, and when movements such as coughs occur. The respiratory, galvanic, and cardiovascular scores are combined with the three measures and weighted equally.

The polygraph examiner designs the questions based upon the relevant facts and the examinee's background and verbal skills.

Examiners in tests like the ones given to petitioners use three types of questions: irrelevant (e.g., name), control (relating to the subject of the examination, but not the key question), and relevant or critical questions (e.g., did you rob the store?). The polygraph examiner infers from the scores whether the examinee was deceptive or truthful, or whether the test is inconclusive.

Countermeasures can sometimes be employed by an examinee to affect the examinee's physiological responses to polygraph examination questions. Up to 25 percent of deceptive persons pass, and up to 50 percent of truthful persons fail. An honest subject is more likely to fail (a "false positive") than a deceptive person is to pass (a "false negative").

There is widespread use of polygraph examinations in and out of Government.

3. Petitioners' Polygraph Examinations

Without notifying respondent's counsel, petitioners' counsel arranged for petitioners to take polygraph examinations. They were performed by Lawrence Wasser of Wasser Consulting Services, Inc., on August. 6, 1990.

Mr. Wasser is a well-qualified polygraph examiner. He has extensive polygraph-related employment experience in and out of Government and numerous leadership positions in national and State polygraphy associations.

Petitioners' counsel told Mr. Wasser about this case and gave him copies of petitioners' tax returns for 1985, 1986, and 1987, the notice of deficiency, and the petition.

Mr. Wasser used the zone comparison technique with control questions. He conducted pre-examination interview discussions with petitioners, and then developed the control and relevant questions. He discussed the topics of the control questions with petitioners.

Mr. Wasser concluded that the examinations showed both petitioners were not deceptive. After Mr. Wasser advised petitioners' counsel of his conclusion, petitioners' counsel told respondent's counsel that the examinations had been performed, and showed that. petitioners were not being deceptive.

OPINION

To corroborate their cash hoard claim, petitioners offered into evidence the results of polygraph examinations which were administered to them unilaterally, without prior notification to respondent. We hold that these polygraph examination results are inadmissible.

1. Federal Rules of Evidence and The Frye General Acceptance Standard

Rule 702 of the Federal Rules of Evidence provides:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

Thus, "Opinion testimony of an expert is admissible if and because it will assist the trier of fact to understand evidence that will determine a fact in issue." *Parker v. Commissioner,* 86 T.C. 547, 561 (1986).

This Court applies the rules of evidence applicable in trials without jury in the United States District Court for the District of Columbia. Sec. 7453. These include the Federal Rules of Evidence. *Snyder v. Commissioner,* 93 T.C. 529, 531 (1989). Consequently, we follow precedents of the United States Court of Appeals for the District of Columbia in interpreting the Federal Rules of Evidence. See *Logan Square Auto Mart, Inc. v. Commissioner,* 291 F.2d 136 (7th Cir. 1961), affg. T.C. Memo. 1960-6. However, as discussed below, petitioners' polygraph examinations would not be admissible under precedents of the United States Court of Appeals for the District of Columbia, or the Sixth Circuit, the circuit to which this case is appealable.

In the Court of Appeals for the District of Columbia a scientific test must be generally accepted in the particular

field in which it belongs to be admissible. *Frye v. United States,* 293 F. 1013 (D.C. Cir. 1923). In *Frye,* a murder prosecution, the court refused to admit results of a systolic blood pressure test, a precursor to the polygraph test. The court stated:

> Just when a scientific principle or discovery crosses the line between the experimental and demonstrable stages is difficult to define. Somewhere in this twilight zone the evidential force of the principle must be recognized, and while courts will go a long way in admitting expert testimony deduced from a well recognized scientific principle or discovery, the thing from which the deduction is made must be sufficiently established to have gained general acceptance in the particular field in which it belongs.

Frye v. United States, supra at 1014.

We disagree with petitioners' assertion that the standard enunciated in *Frye v. United States, supra,* should be rejected because it is outdated. The Court of Appeals for the District of Columbia and the Court of Appeals for the Sixth Circuit continue to apply the *Frye* standard of general acceptance in the relevant scientific community for admission of scientific evidence. *Novak v. United States,* 865 F.2d 718, 722 (6th Cir. 1989); *United States v. Shorter,* 809 F.2d 54, 59-61 (D.C. Cir. 1987); *United States v. Brady,* 595 F.2d 359, 362-363 (6th Cir. 1979); *United States v. Brown,* 557 F.2d 541, 556 (6th Cir. 1977); *United States v. Addison,* 498 F.2d 741, 743 (D.C. Cir. 1974); *United States v. Stifel,* 433 F.2d 431, 438, 441 (6th Cir. 1970). The *Frye* requirement of general acceptance in the relevant scientific field assures that those most qualified to assess the

general validity and reliability of a scientific method have the determinative voice.[2] *United States v. Shorter, supra* at 60; *United States v. Addison, supra* at 744.

We applied the *Frye* standard in *Pacella v. Commissioner*, 78 T.C. 604, 613-617 (1982). In that case respondent sought to introduce evidence that ink analysis showed the ink used was not manufactured when allegedly used by petitioner. We held that ink analysis did not meet the *Frye* standard.

The Court in *United States v. Bursten*, 560 F.2d 779, 785 (7th Cir. 1977), identified factors which Federal courts have considered in rejecting polygraph evidence:

> Among these are the distrust of the accuracy of results based upon a nexus between autonomic discharge and veracity, this skepticism being fueled by disagreement among experts in the field. Also, judges loathe the spector [sic] of trial by machine, wherein each man's sworn testimony may be put to the electronic test. Finally, there exists the apprehension that jurors will abdicate their responsibility for determining credibility, and rely instead upon the assessment of a machine.

The proponent must show that the techniques or procedures involved are "reliable and sufficiently accurate." *United States v. Brown, supra* at 556. Absolute certainty is not required for admissibility of polygraph results nor is it necessary that there be a consensus or unanimity in the appropriate scientific community. *Peteet*

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[2] We do not reject the *Frye* standard as in *United States v. Piccinonna*, 885 F.2d 1529, 1531-1532 (11th Cir. 1989).

v. Dow Chemical Co. 868 F.2d 1428, 1433 (5th Cir. 1989); *United States v. Brown, supra.* The acceptance of a technique or process in the scientific community is synonymous with its reliability. *United States v. Franks,* 511 F.2d 25, 33 n.12 (6th Cir. 1975).

Deciding credibility of witnesses and weight of testimony is the province of the trial court. It is our task to decide the credibility of any lay or expert witness based upon objective facts, the reasonableness of the testimony, the consistency of the statements made by the witness, and, in some cases, the demeanor of the witness. *Quock Ting v. United States,* 140 U.S. 417, 420-421 (1891); *Wood v. Commissioner,* 338 F.2d 602, 605 (9th Cir. 1964), affg. 41 T.C. 593 (1964); *Pinder v. United States,* 330 F.2d 119, 124-125 (5th Cir. 1964); *Concord Consumers Housing Cooperative v. Commissioner,* 89 T.C. 105, 124 n.21 (1987). We recently considered whether expert opinion is useful or helpful for deciding a witness' propensity for truthfulness and veracity; we held it was not. *Friedman v. Commissioner,* T.C. Memo. 1992-89.

Petitioners assert that evidence of general acceptance in the appropriate scientific community may be found in a 1983 Gallup organization survey of a random sample of members of the Society for Psychophysiological Research. Sixty percent of those responding to the survey believed polygraph testing is a useful diagnostic tool when considered with other available information. This poll does not prove general acceptance in the appropriate scientific community as required by *Frye. Dowd v. Calabrese,* 585 F. Supp. 430, 432-433 (D.D.C. 1984) (rejecting use of this 1983 poll to show general acceptability). The poll was commissioned in an attempt to support admission of

polygraph results into evidence in the District of Columbia. About two-thirds of those polled had not used polygraph tests. This poll "can hardly be regarded as a truly scientific, impartial test. The methodology, the questions, the tabulations, and all the other factors which do or do not impart reliability to a poll, were entirely outside the control of anyone but * * * [proponent's] agents." *Dowd v. Calabrese, supra* at 432. Reliability cannot be determined solely by counting scientific noses. *United States v. Williams,* 583 F.2d 1194, 1198 (2d Cir. 1978).

Petitioners argue that the polygraph examination results in this case meet the *Frye* criteria as shown by the testimony of expert witnesses, Drs. Frank Horvath and Stanley Abrams for petitioners and Dr. William Iacono for respondent. The experts estimated a range of polygraph accuracy from 51 to as high as 98 percent, depending on a wide variety of factors. Petitioners argue that there was substantial agreement between all experts who testified as to the general reliability of polygraphy, thus meeting the *Frye* standard. We disagree. Likewise, petitioners read too much into Dr. Iacono's affirmative response to their question on cross-examination, "In other words, is it [polygraphy] a tool that could be used in determining with some degree of reliability truth or deception?" As an example of usefulness, Dr. Iacono said that a polygraph examination may induce some people to confess to wrongdoing. Dr. Iacono also said that the accuracy of a polygraph test is based on faulty theoretical assumptions. The faulty assumptions are: (1) The examiner can formulate questions that the examinee will answer deceptively; (2) all innocent examinees will be more disturbed by the control than by the relevant questions; (3) all deceptive

examinees will be more disturbed by the relevant than by the control questions; and (4) polygraph testing is objective.

Petitioners argue that the widespread use of polygraph examinations by Government agencies and business shows they are reliable. We disagree. We do not believe that widespread use of polygraph testing in business and Government shows that polygraph testing enjoys general acceptance by the relevant scientific community. Instead, we believe there continues to be a bona fide debate in that community about polygraph accuracy. Therefore, we conclude that petitioners have not shown us that results of polygraph examinations are sufficiently established to have gained general acceptance in the relevant scientific community.

Expert testimony must be relevant. Fed. R. Evid. 401. Relevant evidence is evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence. Fed. R. Evid. 401. Petitioners argue that polygraph results are more reliable than not, and thus are relevant under Rule 401 of the Federal Rules of Evidence. However, not all relevant evidence is admissible. For example, even though relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by consideration of undue delay, waste of time, or needless presentation of cumulative evidence. Fed. R. Evid. 403. "[P]olygraph evidence should not be admitted, even for limited purposes, unless the trial court has determined that the 'probative value of the polygraph

evidence outweighs the potential prejudice and time consumption involved in presenting such evidence.' " *United States v. Miller*, 874 F.2d 1255, 1261 (9th Cir. 1989) (quoting *Brown v. Darcy*, 783 F.2d 1389, 1397 n.14 (9th Cir. 1986)). Since we conclude that the *Frye* standard is not met and that the polygraph tests are not admissible under rule 702 of the Federal Rules of Evidence, we need not decide whether they are also inadmissible under rule 403 of the Federal Rules of Evidence.

2. Unilateral Polygraph Testing

Even if polygraph testing were generally accepted in the appropriate scientific community, the results here would be inadmissible. That is because petitioners arranged unilaterally to take the polygraph tests without informing respondent. Mr. Wasser concluded the test showed petitioners' cash hoard claim was truthful. Petitioners then reported the results to respondent. While results of polygraph tests may be admissible by stipulation of the parties, admission of polygraph tests administered unilaterally are not admissible. *Wolfel v. Holbrook*, 823 F.2d 970, 972 (6th Cir. 1987); *Barnier v. Szentmiklosi*, 810 F.2d 594, 596-597 (6th Cir. 1987); *Poole v. Perini*, 659 F.2d 730, 735 (6th Cir. 1981); *Dowd v. Calabrese, supra* at 431; *State v. Dean*, 103 Wis.2d 228, 307 N.W.2d 628 (1981). But see *United States v. Piccinonna*, 885 F.2d 1529 (11th Cir. 1989).

In *United States v. Tucker*, 773 F.2d 136, 141 (7th Cir. 1985), in explaining a refusal to admit results of a lie detector test not agreed in advance to be admissible, the court said:

> The lie detector does not peer into the mind; it is a test of (relative anxiety, and if the person taking the test has nothing to lose and everything to gain, he may not be anxious and his passing the test may prove nothing. Whatever the force of this doubt, it is readily allayed by agreeing to allow the government to put the test results, whatever they may be, into evidence if it wants; and a defendant who refuses to make such an agreement is in a poor position to challenge the district court's exercise of its discretion to refuse to admit the results.

Similarly, the court in *Dowd v. Calabrese, supra* at 433 said: "One of the important factors that many of those who rely on polygraphs insist on is that the individual taking it should know that something real is at stake. Absent such conditions no results of significance can be expected." (Fn. ref. omitted.)

Finally, in *State v. Dean,* 307 N.W.2d at 637, the court said that a stipulation to admit results of polygraph tests:

> encourages discussion and eventual agreement with regard to not only the general subject of the reliability of polygraph testing but also more specific subjects such as the qualifications required of the examiner, the designation of the examiner, the phrasing of the test questions, and the specification of the conditions under which the test is to be given.

We note that the United States Court of Appeals for the District of Columbia has recently said that *Frye* involved a criminal trial, and declined to decide whether *Frye*'s "general acceptance" requirement should be limited to criminal cases, and a less demanding standard,

such as "substantial acceptability" applied in civil cases. *Kropinski v. World Plan Executive Council-U.S.*, 853 F.2d 948, 956 (D.C. Cir. 1988). However, we would not admit results of unilateral tests such as petitioners arranged here under either standard.

We conclude that the results of the polygraph examinations of petitioners are not admissible. We need not decide whether the procedures used in the actual examinations of petitioners were reliable.

Upon due consideration of the foregoing,

Results of petitioners' polygraph examinations will not be considered by the Court in the disposition of this case.

UNITED STATES TAX COURT

GUILIO J. and EDITH CONTI,	)	
Petitoners,	)	Docket No. 15131-90
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed October 19, 1992, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax due from the petitioners for the taxable years 1986 and 1987 in the amounts of $206,701.68 and $322,343.29, respectively;

That there are additions to tax due from the petitioners for the taxable years 1986 and 1987, under the provisions of I.R.C. § 6653(b)(1)(A), in the amounts of $155,026.26 and $241,757.47, respectively;

That there are additions to tax due from the petitioners for the taxable years 1986 and 1987, under the provisions of I.R.C. § 6653(b)(1)(B), and for purposes of computing the 50% interest additions to tax pursuant to I.R.C. § 6653(b)(1)(B), the additions to tax shall be computed on $206,701.68 and $322,343.29, respectively, of the deficiencies; and

That there are additions to tax due from the petitioners for the taxable years 1986 and 1987, under the provisions of I.R.C. § 6661, in the amounts of $51,675.42 and $80,585.82, respectively.

(Signed) John O. Colvin

Judge.

Entered: Jan. 13, 1993

* * *

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

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RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 24

ELECTRONIC CITATION: 1994 FED App. 0379P (6th Cir.)
File Name: 94a0379p.06

No. 93-1281

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GUILIO J. CONTI and EDITH CONTI, *Petitioners-Appellants,*	)	
v.	)	ON APPEAL from the United States Tax Court
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent-Appellee.	)	

Decided and Filed November 9, 1994

Before: MARTIN, RYAN, and SUHRHEINRICH, Circuit Judges.

BOYCE F. MARTIN, JR., Circuit Judge. Guilio J. Conti an his wife Edith appeal the Tax Court's 99 T.C. No. 20, T.C. Memo 1992-616 (1992) finding that they substantially understated their income for 1986 and 1987. The Contis also challenge the penalties imposed for fraud and understatement of their tax liability. We affirm.

The record in this case is extensive and confusing, and we summarize only those facts necessary for an

understanding of this appeal. Because of the lack of supporting documentation and because of large cash transactions, the Contis' tax deficiencies were calculated using the net worth method. We begin by describing the taxpayers' work and financial history. Guilio and Edith Conti are a married couple in their middle seventies, and they have three adult children. Mr. Conti, who is now retired, dropped out of school after the fifth grade and began working at the age of fourteen. From 1937 to 1985 he was employed by Ford Motor Company, except for a period of service in the United States Army from 1942 to 1945. Mr. Conti earned about $60 a month in the army, and earned approximately $679,206 from 1971 to 1985 as a Ford employee. He also claims to have inherited roughly $23,000 from his relatives between 1970 and 1984. During 1984 he testified he withdrew $190,000 from a deferred annuity which had been purchased for $150,000 in 1981.

Edith Conti testified she handled all of the family finances after marrying Mr. Conti in 1949. In 1981, upon the death of her brother, Alfred D'Annunzio, Mrs. Conti inherited jointly-held property worth roughly $237,000. In the early 1980s, at the suggestion of their son, Mark, the Contis started a business involving the purchase, renovation, and sale of real properties. In 1986 and 1987, the Contis bought and sold at least twelve such properties. In several of these transactions, financial institutions loaned money to the Contis for financing the purchase. The Contis maintained numerous bank and brokerage accounts in the 1980s. For example, in 1986 and 1987, Mrs. Conti made more than three hundred deposits into these accounts, totaling more than $950,000. At least one hundred and thirty of these transactions, totaling more

than $375,000, were cash deposits. Finally, during 1985 and 1986, the Contis invested roughly $105,000 in various securities, and realized a profit of more than $18,000 from the sale of these securities.

The Contis' 1986 and 1987 tax returns were prepared by certified public accountant Leonard Grey. In March 1988, Internal Revenue Service Agent Pamela Keysor began auditing these tax returns. Given our self-enforcement of the tax laws, taxpayers are required to retain for a reasonable time the documents which support the entries on their tax returns. Here little was available, and thus the revenue agent had to begin by determining the taxpayers' net worth. This method consists of computing a taxpayer's excess of assets at cost, over liabilities, at the beginning and end of a year. The difference between these two figures is the increase in net worth, which is adjusted by adding non-deductible expenditures and subtracting gifts, inheritances, loans, previously-taxed cash on hand, and the like. While this is clearly a simplistic analysis, generally the final figure obtained from these calculations is considered the taxpayer's taxable income. Here, although the record before us is voluminous, closing statements, loan documents, and checks are missing.

On April 18, Agent Keysor met with Mrs. Conti, Leonard Grey, and the Contis' son, Mark Conti. At this meeting, Mrs. Conti told Keysor that on December 31, 1985, the Contis had about $100,000 in cash at their residence, and "over $20,000" in cash in a safe deposit box. Mrs. Conti stated that these cash reserves were drawn partly from a $200,000 to $250,000 gift from her mother, and partly from a $300,000 inheritance from her brother. Keysor's handwritten notes from the meeting state that

"taxpayer keeps large sum of cash on hand, ($150,000)." Mrs. Conti did not claim at this time that the source of the cash was Mr. Conti's earnings from Ford and military service, nor did she claim that the source of these funds was a series of loans from their son, Mark Conti.

Leonard Grey, after meeting with Keysor again on April 27, met with Mark Conti to prepare a response to Agent Keysor's questions. Grey informed Mark Conti of the amount of cash on hand, or the "cash hoard," that would be required to account for the Contis' net worth increases in 1986 and 1987. On May 23, Grey Sent a letter to Agent Keysor stating that the Contis' cash on hand, at the beginning of 1986, was $450,000. The information in this letter was provided to Grey by Mark Conti. Rejecting this information as not supported by documentation, a determination was made to proceed with a deficiency notice. The Commissioner, using the $150,000 cash on hand figure from Agent Keysor's notes, initially computed the Contis' tax deficiency for 1986 to be $116,410, and their tax deficiency for 1987 to be $390,227. These deficiencies were based on what the Commissioner determined to be over $1,300,000 in unreported income accumulated by the Contis during 1986 and 1987. The Commissioner also determined that the Contis were liable for additions to tax for fraud, under Section 6653(b), and substantial understatement of income tax, under Section 6661. On April 11, 1990, the Commissioner issued a notice of deficiency. On July 6, the Contis sought relief in the Tax Court, challenging the Commissioner's deficiency determination and the additional penalties for fraud and

understatement of income tax. The Commissioner subsequently altered the determination to reflect amended tax deficiencies of $206,702 for 1986, and $322,343 for 1987.

The trial before the Tax Court began on September 30, and ended on October 3, 1991. The Commissioner and the Contis stipulated to the figures in the Commissioner's net worth analysis, with the exceptions of the amounts of the cash hoard and certain loans allegedly made by Mark Conti to his parents. At trial, the Contis contended that the actual amount of their cash hoard, as of December 31, 1985, was roughly $800,000. They claimed that they had amassed this hoard from the following sources: (1) a frugal lifestyle; (2) double and triple shifts worked by Mr. Conti at Ford, without any vacation time; (3) cash gifts from Mrs. Conti's mother, who did not work but had allegedly accumulated cash from the sale of wine and beer during Prohibition; (4) sixteen years of expense-free living with Mrs. Conti's mother in the 1950s and 1960s; (5) Mr. Conti's sales of Nazi weapons during and after World War II; and (6) various bequests and gifts from family members.

The Contis also asserted at trial, for the first time, that Mark Conti had loaned them the separate, aggregate sum of approximately $582,000 during the period from 1986 to 1987. Mark Conti testified that his adjusted gross income for those years was $72,000, earned by syndicating video games, rehabilitating real estate for his parents and others, and financing and developing tennis clubs. Mark Conti also testified that he had roughly $75,000 in savings at the time, plus $170,000 from a divorce settlement. Even with his relatively low income figures, he further testified that, in the period from 1980 to 1985, he

obtained roughly $600,000 to $700,000 in undocumented, unsecured loans from tennis clubs, individuals, and various banks, and loaned some of this money in turn to his parents. Mark Conti's loans to his parents were also undocumented, and stated no due date nor interest rate. The Contis, moreover, did not mention these loans to at least one of the expert witnesses they retained to calculate their net worth and taxable income for 1986 and 1987.

In order to corroborate the amount of their claimed cash hoard, the Contis allegedly told someone representing the Commissioner that they were each willing to undergo a polygraph examination. This offer was rejected. The Contis' counsel, however, without informing either the Tax Court or the Commissioner's counsel, arranged for Mr. and Mrs. Conti to undergo polygraph tests. At trial, the Contis asserted that they passed the tests, corroborating as to their cash hoard claim, and their counsel attempted to introduce the test results into evidence to support this conclusion. After an evidentiary hearing, the Tax Court held that the polygraph tests were unreliable, and, therefore, inadmissible.

On January 13, 1993, the Tax Court entered judgment in favor of the Commissioner. Although it found that the Contis did not lead a lavish lifestyle, the court discredited the Contis' testimony regarding the amount of their cash hoard, and the loans from Mark, as implausible and unconvincing. The court held that the Commissioner had established a reasonable, non-arbitrary opening net worth of $150,000 to support the deficiency determination, and had also negated possible non-taxable income sources as required under *Holland v. United States*, 348 U.S. 121, 125 (1954). The Tax Court stated in its opinion

that the Contis' mortgaging of real property, extensive investment activities, regular bank deposits, lack of documentation regarding purported transactions, and inconsistent pretrial allegations regarding the amount of their cash hoard all weighed against a finding that they had more than $150,000 in cash on hand at the beginning of 1986.

The Tax Court further held that the Commissioner had proven the two elements of fraud under 26 U.S.C. § 6653(b), existence of an underpayment and fraudulent intent, by clear and convincing evidence. With respect to fraudulent intent, the court listed what it considered to be the following "badges of fraud" in the present case: (1) large understatements of income; (2) inadequate records; (3) implausible or inconsistent explanations of behavior; (4) concealment of assets; and (5) dealings in cash. *See Bradford v. Commissioner*, 796 F.2d 303, 307-308 (9th Cir. 1986) (enumerating "badges" indicative of fraudulent intent). Finally, the court held the Contis liable for additions to tax for substantial understatement of income tax, under 26 U.S.C. § 6661, for essentially the same reasons the court advanced in support of its deficiency determination. The Contis subsequently filed this timely appeal challenging the deficiency determination, the penalties for fraud and understatement of income tax, and the exclusion of the polygraph evidence.

As we assess the issues raised by the taxpayers in this appeal, we review the Tax Court's factual findings under a clearly erroneous standard, and review legal questions *de novo*. *Rose v. Commissioner*, 868 F.2d 851 (6th Cir. 1989).

The first issue we address is that of the polygraph tests. The taxpayers maintain that the Tax Court erred in holding the results of these tests to be inadmissible. The court gave two independent reasons for its holding: (1) the tests did not satisfy the "general acceptance" standard of *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923), as applied to Federal Rule of Evidence 702; and (2) this Circuit's decision in *Barnier v. Szentmiklosi*, 810 F.2d 594 (6th Cir. 1987) (holding that "unilateral" polygraph examinations are inadmissible, because negative results presumably would not be disclosed, and nothing is at stake). The Contis now argue that the results of the terms should have been admitted because the United States Supreme Court recently rejected the *Frye* standard, holding that general acceptance is not a prerequisite for the admissibility of scientific evidence under Rule 702, and that it is only one of a number of factors that a court should assess in determining whether to admit such evidence. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 113 S. Ct. 2786, 2794-97 (1993).

The Tax Court, however, also relied on two other Sixth Circuit cases finding unilateral polygraph tests inadmissible under Federal Rule of Evidence 403. *See Wolfel v. Holbrook*, 823 F.2d 970, 972 (6th Cir. 1987), *cert. denied*, 484 U.S. 1069 (1988); *Barnier*, 810 F.2d at 596-97. If this basis for exclusion is valid, we need not consider whether the Tax Court actually conducted a proper analysis of the polygraph evidence under the Supreme Court's decision in *Daubert*, with respect to Federal Rule of Evidence 702, but can affirm the denial of the polygraph results on an independent basis.

In *Barnier,* which involved a civil suit for malicious prosecution, we concluded that the trial court erred in admitting polygraph evidence for the purpose of bolstering the plaintiffs' credibility regarding damages because the plaintiffs submitted to the polygraph test voluntarily, the defendants were unaware of the test, and the results of the test presumably would not have been disclosed if they had been unfavorable. *Barnier,* 810 F.2d at 597. Given these circumstances, we have concluded on several occasions that the prejudicial effect of such polygraph test results outweighs their probative value under Federal Rule of Evidence 403, because the party offering them did not have an adverse interest at stake while taking the test. *Id.; see also United States v. Harris,* 9 F.3d 493, 502 (6th Cir. 1993) (trial court did not abuse discretion in excluding criminal defendant's statement that he was willing to take polygraph test, because defendant did not agree that results of test, if taken, would be admissible); *Wolfel,* 823 F.2d at 974 (same in the context of a prisoner's statement in a civil rights action against a corrections officer).

The Contis argue that, rather than apply the reasoning of this line of cases, we should look to the rationale of an Eleventh Circuit decision, *United States v. Piccinonna,* 885 F.2d 1529 (11th Cir. 1989) (en banc). In *Piccinonna,* the Eleventh Circuit stated that polygraph evidence is admissible by stipulation between the parties or when used to impeach or corroborate the testimony of a witness during trial. *Id.* at 1536. In this latter situation, admission is subject to three preliminary conditions:

> *First, the party planning to use the evidence at trial must provide adequate notice to the opposing party that the expert testimony will be offered.* Second,

> polygraph expert testimony by a party will be admissible only if the opposing party was given reasonable opportunity to have its own polygraph expert administer a test covering substantially the same questions. . . .
>
> Finally, whether used to corroborate or impeach, the admissibility of the polygraph administrator's testimony will be governed by the Federal Rules of Evidence for the admissibility of corroboration or impeachment testimony. . . . Even where the above three conditions are met, admission of polygraph evidence for impeachment or corroboration purposes is left entirely to the discretion of the trial judge.

(emphasis added). *Id.* While we have not adopted this view in full, our decisions in *Barnier* and *Wolfel,* are equally applicable to the present case. *Groves v. Ring Screw Works, Ferndale Fastener Div.,* 882 F.2d 1081, 1086 (6th Cir. 1989), *rev'd on other grounds,* 498 U.S. 168 (1990). Nonetheless, *Piccinonna* is not entirely inconsistent with our polygraph precedent, as the Eleventh Circuit stated the trial court may still exclude such evidence, in its sole discretion, under Rule 403. *Piccinonna,* 885 F.2d at 1536. *Barnier* and *Wolfel,* which we apply here, state a stricter rule of exclusion – that unilaterally obtained polygraph evidence is almost never admissible under Evidence Rule 403. *Wolfel,* 823 F.2d at 973-75; *Barnier,* 810 F.2d at 597.

Here, neither the Tax Court nor the Commissioner were aware that the Contis voluntarily and unilaterally arranged for polygraph tests after the Commissioner refused to agree to such tests. While the prejudicial effect of the tests were not as severe as in *Barnier* and *Wolfel,* the

Tax Court properly relied on these cases as an independent basis to deny the admission of the polygraph evidence.

The Contis next assert that the Tax Court improperly used an arbitrary opening net worth of $150,000, and that the decision was against the "great weight" of the evidence. The Commissioner bears the burden of establishing an opening net worth with "reasonable certainty," and must either show a likely source of taxable income or negate possible sources of non-taxable income in using the net worth method to support a deficiency determination. *Holland*, 348 U.S. at 135-38; *United States v. Massei*, 355 U.S. 595 (1958) (per curiam). The Commissioner's deficiency determination is presumptively correct, absent several exceptions not present here, and, once it is made then the burden shifts to the taxpayer to prove that the determination is erroneous or arbitrary. *Kearns v. Commissioner*, 979 F.2d 1175, 1178 (6th Cir. 1992). Here, the Tax Court, using its factual findings, held that the Commissioner's determination, as adjusted, was correct because the Commissioner had negated all possible sources of non-taxable income claimed by the Contis. These possible sources of non-taxable income were limited to the claimed cash hoard and the alleged loans from Mark Conti. The remainder of the net worth figures were stipulated. Once again we review the Tax Court's factual findings, including its ultimate deficiency determination, for clear error. *Id.*; *Rose v. Commissioner*, 868 F.2d 851, 853 (6th Cir. 1989).

The taxpayers argue that the record does not support the findings of large amounts of unreported income in 1985 and 1986. They maintain that the Tax Court erred by

not crediting their unrebutted testimony regarding the cash hoard and the loans from Mark Conti. Generally, a taxpayer's unimpeached, competent, and relevant testimony "may not be arbitrarily discredited and disregarded" by the court. *Loesch & Green Const. Co. v. Commissioner,* 211 F.2d 210, 212 (6th Cir. 1954). However, the Tax Court, like any other court, "may disregard uncontradicted testimony by a taxpayer where it finds that testimony lacking in credibility," *Lerch v. Commissioner,* 877 F.2d 624, 631 (7th Cir. 1989); *Estate of DeNiro v. Commissioner,* 746 F.2d 327, 331 (6th Cir. 1984), or finds the testimony to be "improbable, unreasonable or questionable." *Lovell & Hart, Inc. v. Commissioner,* 456 F.2d 145, 148 (6th Cir. 1972) (per curiam) (quoting *Commissioner v. Smith,* 285 F.2d 91, 96 (5th Cir. 1960)). Just as with an administrative law judge in a proceeding before the National Labor Relations Board or Social Security Administration, we give deference to the Tax Court's credibility findings because of the court's opportunity to observe the witnesses and their demeanor when they testify. Once the Tax Court finds that the taxpayer's testimony lacks credibility, "if the taxpayer has offered no other evidence in support of his position, the Tax Court has no choice but to rule for the Commissioner, since the taxpayer has failed to carry his requisite burden of proof," *Lerch,* 877 F.2d at 631. Such is the case here with the Contis. They have offered virtually no evidence to support their burden of proof.

Here, the Tax Court legitimately characterized the Contis' testimony regarding their purported $800,000 cash hoard and loans from Mark Conti as improbable, unreasonable, and unbelievable. In making this finding,

the court observed that the Contis' testimony was inconsistent with their earlier statements, made to Agent Keysor both in person and in Leonard Grey's letter setting out a smaller cash hoard. There just was no documentation or other credible evidence introduced during a three-day trial to support the Contis' claims. The Contis now contest the evidentiary weight given to their earlier statements, and assert that the burden of proof with respect to the arbitrariness of the deficiency determination shifted back to the Commissioner because of the inaccuracies in the original notice of deficiency. It is well-established, however, that after the Tax Court and the Commissioner correct inaccuracies in the original deficiency notice, as happened here, the burden of proof remains with the taxpayer to prove that the ultimate deficiency determination is erroneous or arbitrary. *Kearns*, 979 F.2d at 1178. In that regard, the Tax Court did not err in finding that the Contis possessed a $150,000 cash hoard, a figure the Commissioner established with reasonable certainty based on Mrs. Conti's statements to Agent Keysor. The Contis also argue that the tax court judge unfairly "intervened" during their cross-examination of Agent Keysor in order to prevent her from admitting that the $150,000 cash hoard figure was arbitrary. We have examined the transcript of the proceedings before the Tax Court, and find this argument to be completely meritless. The Tax Court's ultimate deficiency determination, which followed from its cash hoard finding and its rejection of Mark Conti's testimony regarding loans to his parents, also is not clearly erroneous nor arbitrary, because the Contis did not come forward with documentary evidence to meet their burden of proof on that issue. Thus, the Tax

Court did not err by imposing the statutory penalty, under 26 U.S.C. § 6661, for understatement of income tax.

The Contis further maintain that the Tax Court erred in imposing an additional tax penalty for fraud. The two elements of fraud are existence of an underpayment and fraudulent intent. 26 U.S.C. § 6653(b). The Commissioner bears the burden of establishing fraud by clear and convincing evidence, and we review the Tax Court's factual finding of fraud for clear error. *Foster v. Commissioner*, 487 F.2d 902, 903 (6th Cir. 1973) (per curiam). Here, the Tax Court did not err in finding that the Commissioner had established fraud, given the Contis' implausible and undocumented allegations, their extensive dealings in cash, and their large understatements of income.

Finally, both parties agree that the Tax Court made a computational error in determining the Contis' 1986 tax deficiency. Although the Contis' real estate investments at the end of 1985 were stipulated to be $255,630, the Tax Court used the figure of $225,630 in calculating the Contis' 1986 net worth. The Tax Court then based its deficiency determination on the net worth calculation. Accordingly, we affirm the judgment of the Tax Court on the merits for the foregoing reasons, but remand the case for correction of the mathematical error, and recalculation of the Contis' 1986 deficiency.